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94-58 JUL - 8 1994

No. OFFICE OF THE CLERK

In The

# Supreme Court of the United States

October Term, 1994

GENERAL ELECTRIC CAPITAL CORPORATION and AVEMCO INSURANCE COMPANY,

*Petitioners,*

*vs.*

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, P.A.,

*Respondent.*

*Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit*

## PETITION FOR WRIT OF CERTIORARI

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95 pp

## QUESTIONS PRESENTED FOR REVIEW

National Union Fire Insurance Company of Pittsburgh, P.A. (hereafter referred to as "National Union") brought this suit seeking a declaration that there was no coverage under an Aircraft Insurance Policy (hereinafter referred to as "the Policy") with respect to the confiscation of a Piper Cheyenne 400LS Aircraft, Serial No. 42-5527030, Aircraft N # 41198 (hereinafter referred to as "the Aircraft") by the Columbian Government and resulting damages to the Aircraft. The Policy included a Breach of Warranty Endorsement for General Electric Capital Corporation's (hereinafter referred to as "GECC") benefit, with a limitation of coverage in the event there was a conversion by or at the direction of the Named Insured. National Union claimed the Aircraft was converted by Care Flight Air Ambulance Service, Inc. (hereinafter referred to as "Care Flight"), the Named Insured, subletting the Aircraft without authorization. The District Court granted summary judgment in favor of National Union based upon its finding that as a matter of law, Care Flight converted the Aircraft, and its concluding that the "conversion" limitation found within the Breach of Warranty Endorsement of the Policy superseded the extended coverage of the War, Hijacking, Extortion and Perils Extended Coverage Endorsement of the Policy (hereinafter referred to as the "War Risk Endorsement") in the event the Aircraft was confiscated. The Court of Appeals affirmed the District Court's Judgment (hereinafter both the District Court and the Court of Appeals are referred to as the "Courts") finding that "Once Care Flight converted the aircraft, potential insurance coverage for a subsequent event became irrelevant."

The question for review is the error in concluding that the "conversion" limitation in the Breach of Warranty Endorsement superseded the War Risk Endorsement's extended coverage in the event the Aircraft was confiscated. The Courts erred by concluding that such provision was an exclusion, rather than a limitation of

coverage. More significantly, the Courts erred by failing to follow the *Erie* doctrine and to apply special rules of construction under Texas law when there is an ambiguity in an insurance contract. By holding that the conversion limitation controlled over the coverage of the War Risk Endorsement, when the construction providing coverage (*i.e.*, that the War Risk Endorsement provides coverage for confiscation of the Aircraft "notwithstanding anything in the policy to the contrary") was a reasonable construction, the Courts erred by failing to follow Erie's mandate.

## LIST OF PARTIES AND CERTIFICATE UNDER FED. R. APP. P. 26.1

The undersigned counsel of record certifies that the following parties have an interest in the outcome of this case.

| Persons | Connection or Interest |
|---|---|
| National Union Fire Insurance Company of Pittsburgh, P.A. | Plaintiff |
| Care Flight Air Ambulance Service, Inc. | Defendant |
| General Electric Capital Corporation<br>General Electric Capital Corporation is a wholly-owned subsidiary of General Electric Company<br>General Electric Company's stock is publicly traded. | Defendant |
| AVEMCO Insurance Company<br>AVEMCO Corporation is the parent corporation of AVEMCO Insurance Company, and its stock is publicly traded. AVEMCO Insurance Company has affiliated corporations, none of which are publicly traded. | Defendant |

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## OPINIONS BELOW

Judgment of February 16, 1993 (App. B, 16a); Memorandum Opinion and Order of November 2, 1992 (App. D, 24a) and Memorandum Opinion and Order of January 19, 1993 (App. C, 18a) (all unpublished) in *National Union Fire Insurance Company of Pittsburgh, PA. v. Care Flight Air Ambulance Service, Inc.*, General Electric Capital Corporation and Avemco Insurance Company; Civil Action No. 3-91-1187-H; In the United States District Court for the Northern District of Texas, Dallas Division.

*National Union Fire Insurance Company of Pittsburgh, PA. v. Care Flight Air Ambulance Service, Inc., et al*; 18 F.3d 323 (5th Cir. 1994) (App. A, 1a).

## STATEMENT OF JURISDICTION

The statutory provisions which confer jurisdiction on this Court to decree by writ of certiorari are 28 U.S.C. § 1254(1) and Rules of the Supreme Court of the United States, Rule 10(1)(a).

The Court of Appeals had jurisdiction of the appeal pursuant to 28 U.S.C. § 1291. The Judgment and Opinion of the Court of Appeals was signed on April 12, 1994. No motion for rehearing was filed.

## RULE INVOLVED

Federal Rule of Civil Procedure 56(c):

> **(c) Motion and Proceedings Thereon.** The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment

> sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, *show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.* A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

## STATEMENT OF THE CASE

On March 3, 1989, Care Flight executed an aircraft lease agreement (hereinafter referred to as "the Lease") with GECC to lease the Aircraft. An express condition to Care Flight's use of the Aircraft was its obtaining adequate insurance for the Aircraft. The Lease provided that such coverage would include both breach of warranty insurance and confiscation and war risk insurance and would name GECC as owner of the Aircraft and as loss payee and as an additional insured.

On March 5, 1989, National Union, as insurer, and Care Flight, as insured, executed the Policy, which Policy contains both the War Risk Endorsement and the Breach of Warranty Endorsement, which latter endorsement named GECC as well as the insured as beneficiaries. The Breach of Warranty Endorsement provides in pertinent part:

> As to the interest of the said Lienholder [GECC] only, the Insurance afforded by any Physical Damage Coverage of this policy shall not be invalidated by any act or neglect of the Named Insured, nor by any change in the title

> or ownership of the Aircraft, but conversion, embezzlement or secretion by or at the direction of the Named Insured is not covered hereunder.

(App. E, 39a).

The War Risk Endorsement provides in pertinent part:

> In consideration of $ *Included* additional premium, it is understood and agreed that *notwithstanding anything in the policy to the contrary,* this endorsement provides the coverages shown below . . . .
>
> Subject to the terms, conditions and limitations set out below this endorsement covers physical loss of or damage to the aircraft specified in item 4 of the Declarations page caused by . . . .
>
> (e) Confiscation, nationalisation, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any Government (whether civil, military or de facto) or public or local authority.
>
> (f) Hijacking or any unlawful seizure or wrongful exercise of control of the aircraft or crew in flight (including any attempt at such seizure or control) made by any person or persons on board the aircraft acting without the consent of the insured.

(App. F, 42a).

Care Flight subleased the Aircraft to James Coltharp (hereinafter referred to as "Coltharp") without the prior consent of GECC. The Sublease prohibited Coltharp from subletting the Aircraft and contained substantial restrictions as to use of the Aircraft. The Courts found that the *act of conversion* was in Care Flight's subletting the Aircraft to Coltharp.

Coltharp was *not* an employee, officer, director or agent of Care Flight. Coltharp sublet the Aircraft to Anthony Contraras (hereinafter referred to as "Contraras") for his alleged use in a gold mining business in Brazil. The evidence was disputed as to whether Care Flight participated in or knew of Coltharp's subletting the Aircraft to Contraras and Contraras's use of the Aircraft. While the Aircraft was in the possession of Contraras, the Columbian Government in fact seized and confiscated the Aircraft.

GECC was notified by Care Flight on September 1, 1989 that the Aircraft had been confiscated by the Columbian Government, and that Care Flight was undertaking to obtain the Aircraft's release from the Columbian Government. The damages to GECC included loss of the Aircraft and physical damage to the Aircraft.

National Union brought this action for declaratory relief that there was no coverage under the Policy with respect to the confiscation of the Aircraft by the Columbian Government. The District Court acquired jurisdiction of this action pursuant to 28 U.S.C. § 1332. On February 16, 1993, a Final Judgment was filed in this action. (App. B, 16a)

## ARGUMENT SUPPORTING THE GRANTING OF THE PETITION FOR CERTIORARI

Before addressing the merits of the particular issues which were decided by the Courts, Petitioners would point out the broader concern which supports this Supreme Court's granting the

Petition for Writ of Certiorari. There has been considerable discussion as to the advisability or merits of the diversity jurisdiction granted to the federal courts. Without attempting to address the merits of diversity jurisdiction (such being an issue more properly addressed to Congress), Petitioners would point out that one clear abuse of parties' invoking diversity jurisdiction is forum shopping. Petitioners recognize that forum shopping necessarily arises when there is diversity jurisdiction; however, abuse arises when a party chooses a forum which it perceives will provide a result more favorable than another. As long as forum shopping is based upon subjective suspicions and beliefs of litigants and their counsel, there is little harm. However, when forum shopping can be based on objective fact—that one forum will be more favorable by not strictly adhering to state law, then such forum shopping becomes an abuse of the diversity jurisdiction granted to the federal courts. By reason of this concern, in exercising their diversity jurisdiction, federal courts must zealously adhere to following state law in diversity cases. *Erie Railroad Co. v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938); *Burns v. Gleason,* 819 F.2d 555, 556 (5th Cir. 1987). As Justice Brandeis held in *Erie:*

> Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or "general," be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power

upon the federal courts. As stated by Mr. Justice Field when protesting in Baltimore & Ohio R. Co. v. Baugh, 149 U.S. 368, 401, against ignoring the Ohio common law of fellow servant liability:

> "I am aware that what has been termed the general laws of the country—which is often little less than what the judge advancing the doctrine thinks at the time should be the general law on a particular subject—has been often advanced in judicial opinions of this court to control a conflicting law of a State. I admit that learned judges have fallen into the habit of repeating this doctrine as a convenient mode of brushing aside the law of a State in conflict with their views. And I confess that, moved and governed by the authority of the great names of those judges, I have, myself, in many instances, unhesitatingly and confidently, but I think now erroneously, repeated the same doctrine. But notwithstanding the great names which may be cited in favor of the doctrine, and notwithstanding the frequency with which the doctrine has been reiterated, there stands, as a perpetual protest against its repetition, the Constitution of the United States, which recognizes and preserves the autonomy and independence of the States—independence in their legislative and independence in their judicial

> departments. Supervision over either the legislative or the judicial action of the States is in no case permissible except as to matters by the Constitution specifically authorized or delegated to the United States. Any interference with either except as thus permitted, is an invasion of the authority of the State and, to that extent, a denial of its independence. . . ."
>
> Thus, the doctrine of Swift v. Tyson is, as Mr. Justice Holmes said, "an unconstitutional assumption of powers by courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct." In disapproving that doctrine we do not hold unconstitutional 34 of the Federal Judiciary Act of 1789 or any other Act of Congress. We merely declare that in applying the doctrine this Court and the lower courts have invaded rights which in our opinion are reserved by the Constitution to the several States.

This Court's power of supervision should be exercised in those instances when lower federal courts substantially depart from and/or disregard substantive state law as enunciated by the highest court of a state. Otherwise, the credibility of our judicial system comes into question. By making this point, Petitioners do not suggest that the District Judge or the panel of appellate judges who heard the appeal of this action intentionally, deliberately or consciously disregarded the substantive law of Texas in order to reach the conclusions which they made. Rather, the crux of Petitioners' concern is that when federal judges unconsciously and/

or unwittingly become lax in following the substantive law of a state in diversity cases, parties will find it opportune to forum shop and abuse diversity jurisdiction for purposes of evading the strict application of that state substantive law unfavorable to them.

This Petition for Writ of Certiorari brings this issue to the forefront. In particular, a substantive rule of construction of insurance contracts as enunciated by the Texas Supreme Court, unfavorable to Respondent, was ignored and apparently disregarded by the lower courts in construing the Policy in question. Respondent was fully aware of the adverse state substantive law, as it was the losing party before the Texas Supreme Court, when the Texas Supreme Court recently restated the special rule of construction in holding against Respondent. As will be noted below, such substantive rule of construction of insurance contracts is especially applicable in this declaratory action. Yet, Respondent successfully avoided its application in this action.

No doubt, had Respondent filed such declaratory action in a state district court, the appeal of which would reach the Texas Supreme Court, Respondent would expect a like result to that in *National Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W. 2d 552, 555 (Tex. 1991). However, by filing its declaratory action in the United States District Court, Respondent avoided such confrontation before the Texas Supreme Court. Petitioners have no problem with a declaratory judgment action brought in federal court, had the lower courts strictly applied state substantive law as enunciated by the Texas Supreme Court. But, by their failure to do so, Petitioners contend that Respondent has gained a result which it could not achieve by litigating in the state courts of Texas. If such is the case, diversity jurisdiction has been perverted into an unseemly tool for parties to avoid even-handed justice.

## SUMMARY OF ARGUMENT

The District Court's grant of summary judgment in favor of National Union was basically premised upon two issues:

(1) The first issue is a question of law. This question of law is of significant importance in connection with the lending/leasing of goods and products throughout the United States. Generally, as part of the bargain for the lending or leasing of goods, the secured party/lessor requires of the debtor/lessee that it obtain adequate insurance coverage to insure the goods from the risks to which it may be exposed, and obtain an endorsement to that coverage insuring the secured party/lessee's interest from such risks as well. Such endorsements are sometimes known as breach of warranty endorsements. The boiler plate of such endorsements provide coverage to the secured party/lessee for such risks, which coverage protects the secured party/lessee regardless of the acts or neglect of the debtor/lessee, but provides that conversion, embezzlement or secretion by or at the direction of the debtor/lessee is not covered. Through the years, courts have construed such language so as to expose the secured party/lessor to loss without coverage, should the debtor/lessee steal, embezzle or secrete the goods insured, even if later the goods were seized and confiscated by a government and the loss to the secured party/debtor was caused by such seizure or confiscation. In order to limit such exposure, secured parties/ lessees have required their debtors/lessees to acquire an additional endorsement, known as a war risk endorsement, to provide coverage for such risks notwithstanding the limitations in the breach of warranty endorsement. In our case, the Courts have misconstrued the Policy and the proper interplay between the two endorsements, thereby destroying secured parties/lessors' reasonable expectations as to their coverage in the event their goods are stolen by the debtors and later seized by a governmental body.

The District Court departed from the accepted and usual course of judicial proceedings in making an improper construction of the Policy by disregarding Texas substantive law with respect to the construction of insurance policies. The Court of Appeals sanctioned such a departure. This Court's power of supervision should be exercised such that lower courts, which are mandated under *Erie, supra,* to follow state substantive law in diversity cases, do in fact follow both the spirit and letter of state law, and do not create a separate body of law with little regard to the precedents of state law. Insurers have been known to forum shop by filing declaratory judgment actions in federal courts seeking a declaration of no coverage under their policies, thereby avoiding state courts, especially those in Texas, which apply stricter rules of construction against insurers to such policies. Thus, two bodies of law emerge on the same subject—one enunciated by the state courts and another different body of law in federal diversity cases. In this action, the federal courts have failed to follow Texas precedents with respect to the proper construction to be given the Policy. To appreciate this point, a more detailed description of the particular issues before the Courts is in order.

The issue whether there was coverage for GECC when the Aircraft was confiscated, even under circumstances in which the Aircraft had been converted by the Named Insured, is evidenced by the two endorsements in the Policy. In their construction of the Policy, the Courts found no coverage by classifying the conversion limitation within the Breach of Warranty Endorsement as an exclusion and concluding that it superseded all other provisions in the Policy, including the all-inclusive provision for coverage of risks in the War Risk Endorsement. The two Courts erred in construing the conversion limitation as an exclusion. It was not. As a limitation of coverage, the provision did not exclude coverage otherwise provided in the Policy. They further erred in making such construction, in that the War Risk Endorsement specifically provided that coverage existed in the event of confiscation

"*notwithstanding anything in the policy to the contrary.*" The War Risk Endorsement was special coverage which Care Flight obtained, and which GECC required under the terms of the Lease, in addition to the coverage which would be provided by the Breach of Warranty Endorsement. The proper construction of the Policy is that there was coverage for the confiscation of the Aircraft "notwithstanding anything in the policy to the contrary," which necessarily included the "conversion" limitation of the Breach of Warranty Endorsement. The two Courts erred in improperly reconciling the Breach of Warranty Endorsement's conversion limitation with coverage provisions in the War Risk Endorsement *by failing to apply Texas precedent* as to the proper construction of the Policy. Texas precedent holds that an insurance contract should be construed against the insurer, and when two provisions in a policy conflict, or when there is an ambiguity, that construction which provides coverage supersedes the other, even if the construction denying coverage is more reasonable. The Courts were required under Texas law to either find that Petitioners' construction of the Policy was unreasonable, or construe the Policy to recognize coverage. Had they properly applied the Texas substantive law, the two Courts could only have concluded that summary judgment should have been denied.

(2) The second basis which the District Court found to support summary judgment involved issues of fact. The District Court found that as a matter of law, there was a conversion of the Aircraft by the Named Insured based on the facts. However, the District Court departed from the accepted and usual course of judicial proceedings by deciding a *disputed* issue of fact, in disregard of Rule 56(c)'s standard of review, and the Court of Appeals has sanctioned such a departure. Such departure again calls for the exercise of this Court's power of supervision.

## ARGUMENT

### I. The Standard of Review Which Should Have Been Applied

Judgment was entered based upon the District Court granting National Union's Motion for Summary Judgment. Summary judgment is proper when the pleadings and evidence on file show that no genuine issue exists as to any material fact and that the moving party is entitled to judgment or partial judgment as a matter of law. *See* Fed. R. Civ. P. 56. *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986). As held in *Christophersen v. Allied-Signal Corp.*, 902 F.2d 362, 364 (5th Cir. 1990):

> Before a court may grant summary judgment, the moving party must demonstrate that it is entitled to judgment as a matter of law because there is no actual dispute as to an essential element of the plaintiff's case. . . .
>
> . . . [A]ll evidence must be viewed in the light most favorable to the motion's opponent. *See Gremillion v. Gulf Coast Catering Co.*, 904 F.2d 290, 292 (5th Cir. 1990).

In *Bank of Commerce of Laredo v. City Nat'l Bank of Laredo*, 484 F.2d 284 (5th Cir. 1973), *cert. denied*, 94 S. Ct. 1609, 416 U.S. 905, the Fifth Circuit restated the proper standard of review for the appellate court reviewing a summary judgment.

> When reviewing a case disposed of under Fed. R. Civ. P. 56, an appellate court must apply the same general standard as that initially employed by the trial court - whether there is any genuine issue as to any material fact and

> whether the movant is entitled to judgment as a matter of law.

As held in *Yazzie v. Olney, Levey, Kaplan & Tenner,* 593 F.2d 100 (9th Cir. 1979):

> Our role in reviewing the grant of summary judgment is to determine whether there is any genuine issue of material fact underlying the adjudication and, if not, whether the substantive law was correctly applied. *Inland Cities Express. Inc. v. Diamond Nat'l Corp.,* 524 F.2d 753, 754 (9th Cir. 1975); *Vickory v. Fisher Governor Co.,* 417 F.2d 466, 468 (9th Cir. 1969).

With respect to the error in misconstruing the Policy, the standard of review is to determine whether the substantive law was correctly applied. The Fifth Circuit reviews matters of contract interpretation *de novo.* Inasmuch as the Policy, including all of its endorsements, were part of the summary judgment evidence, the construction placed upon the Policy is basically a question of law. At issue is whether both courts, in construing the Policy and its endorsements, correctly applied Texas law peculiar to the construction of insurance policies.

However, with respect to the error in finding that there was a conversion as a matter of law, the review is to determine whether there was a genuine issue of material fact, *i.e.*, whether reasonable minds could differ in *weighing* the evidence as to the "seriousness" of the interference by Care Flight's subletting the Aircraft and whether the substantive law was correctly applied.

## II. The War Risk Endorsement Prevails

### *A. An Ambiguity Arose Between the Two Endorsements*

The Policy included two endorsements, the terms of which conflict and create an ambiguity. The Breach of Warranty Endorsement (App. E), with certain qualifications, provides that the loss under the physical damage coverage provided in the Policy is payable to the insured and GECC, and as to GECC, the insurance afforded would not be invalidated by any act or neglect by Care Flight, but conversion, embezzlement or secretion by or at the direction of the named insured would not be covered.

Whereas, the War Risk Endorsement (App. F) provided coverage, "notwithstanding anything in the policy to the contrary" for physical loss or damage to the Aircraft caused by confiscation, seizure, etc. and coverage as well for any wrongful exercise of control of the Aircraft made by any persons without the consent of Care Flight.

The Court of Appeals held with respect to Petitioners' construction of the interplay between the two endorsements, "The result appellants seek would make the conversion exclusion to the breach of warranty endorsement meaningless." Petitioners disagree,[1] but the construction which the Court of Appeals did make rendered the extended coverage under the War Risk

---

1. In reply to the Court of Appeal's argument that Defendants' construction renders the conversion exclusion meaningless, Defendants must disagree. The War Risk Endorsement (App. F), by its all-embracing coverage—"notwithstanding anything in the policy to the contrary"— must be construed to supersede and modify the conversion limitation of the Breach of Warranty Endorsement *in those circumstances when there is a risk covered under the War Risk Endorsement.* That is, while the "conversion" limitation would otherwise have effect for all other risks, such limitation does not *affect* coverage for those specified risks in the War Risk Endorsement.

Endorsement, which was to provide coverage "notwithstanding anything in the policy to the contrary," meaningless. Obviously, the two endorsements' provisions conflicted. Thus, an ambiguity arose and the rules of construction of contracts under Texas law controlled. Those rules were ignored; the Courts instead found which of the two constructions was more reasonable in their minds and held accordingly. Under Texas law, if the construction which provides coverage is a reasonable one, it must control, even if the construction denying coverage is more reasonable. The Courts did not recognize or apply such rule and failed to make a reasoned explanation why the construction favoring coverage was not reasonable. Their arguments do not bear up to close scrutiny.

*B. The Proper Meaning of the War Risk Endorsement*

The Courts accepted National Union's contention that there was no coverage under the Policy by reason of the conversion limitation in the Breach of Warranty Endorsement. The "conversion" limitation within the Breach of Warranty Endorsement (App. E) must be read in the context of the entire Policy, including the extended coverage provided in the War Risk Endorsement, when the loss results from confiscation and seizure. The War Risk Endorsement (App. F) *provided for its own exclusions of coverage.* There were no exclusions or limitations within the War Risk Endorsement limiting or denying coverage in the event of a conversion of the Aircraft. The War Risk Endorsement provided coverage for all physical damage caused by confiscation, seizure, etc., *notwithstanding anything in the policy to the contrary,* which would necessarily include so-called "exclusions" found in the Breach of Warranty Endorsement.

Inasmuch as it is undisputed that the Aircraft was confiscated and seized by the Columbian Government, there was coverage under the policy for GECC's loss. The War Risk Endorsement did not provide that its coverage was to be limited or excluded by

general exclusions in the Policy. It expressly set forth those special exclusions which would affect its coverage. (App. F).

The Court of Appeal's analysis of the meaning of the War Risk Endorsement is patently wrong. The "fundamental" premise of the Court of Appeal's argument to support its misconstruction of the terms of the Policy is its reference to the language found in the War Risk Endorsement which provides, "Nothing herein contained shall vary, alter, waive or extend any of the terms, provisions, representations, conditions or agreements of the Policy other than as above stated." The Court of Appeals argues that from this sentence, the parties' intentions were that the War Risk Endorsement's coverage would not vary the conversion exclusion in the Breach of Warranty Endorsement. Such argument is wrong and certainly not supported in the summary judgment evidence. *In fact the very same sentence appears at the end of the Breach of Warranty Endorsement.* In its construction, the Court of Appeals ignores the significant last five words in the sentence "*other than as above stated.*" Certainly, the very same sentence's inclusion in the Breach of Warranty Endorsement does not mean that as to the lienholder, all conditions, limitations and exclusions of the Policy which affect the insured also affects the lienholder's coverage. Case after case has held that not to be the case. *American National Bank & Trust Co. v. Young,* 329 N.W. 2d 805, 811 (Minn. 1983). Such language in the Breach of Warranty Endorsement meant that *except with respect to* the coverages expressly set forth therein, the Breach of Warranty Endorsement did not alter, waive or extend any other terms of the Policy, which necessarily included the terms of the War Risk Endorsement.

Likewise, the use of the sentence, "Nothing herein contained shall vary, alter, waive or extend any of the terms, . . . *other than as above stated*" in the War Risk Endorsement is of similar effect. That is, the War Risk Endorsement is not to affect the coverage of the Policy *except with respect to coverage for the specified risks*

*covered therein.* That is, the clause "*other than as above stated*" emphasizes that the War Risk Endorsement provides special coverage to its insureds for the specified risks set forth therein, but otherwise, the terms of the Policy are not to be varied. When the War Risk Endorsement is construed as part of the separate contract of the *insured,* the insured has coverage for the risks specifically covered therein, notwithstanding any exclusions or conditions in the Policy to the contrary. Likewise, with respect to GECC as the insured lienholder, the War Risk Endorsement provides that the lienholder has coverage for the specified risks therein notwithstanding anything in its Policy to the contrary, which necessarily includes any conditions or exclusions in the Breach of Warranty Endorsement. The last sentence in both the Breach of Warranty and War Risk Endorsements that "nothing herein contained shall vary, alter, waive or extend any of the terms . . . *other than as above stated,*" means precisely that. Moreover, the necessary corollary to such sentence is that to the extent that *there is coverage stated above,* especially in the War Risk Endorsement with its "notwithstanding" clause, such War Risk Endorsement *does* vary, alter, waive and extend the terms, provisions, representations, conditions and agreements of the Policy, including the Breach of Warranty Endorsement's exclusions.

### *C. Texas Rules of Construction Decides Such Ambiguity in Favor of Coverage*

There is coverage for loss of the Aircraft by confiscation even under the Breach of Warranty Endorsement (App. E) when Texas rules of construction are correctly applied. The conversion limitation of the Breach of Warranty Endorsement must be construed with the War Risk Endorsement, (App. F) when there has been a confiscation. Under Texas law, when the War Risk Endorsement is read together with the Breach of Warranty Endorsement, the Policy should be construed so as to recognize that if the Aircraft is confiscated, the Breach of Warranty Endorsement will not invalidate coverage to GECC.

It is fundamental Texas law that where policy provisions are inconsistent, or when read together, they give rise to an ambiguity as to the extent of policy coverage, the contract should be construed in favor of coverage and against limitations which would inure to the benefit of the insurance company. Such principle is especially applicable to construing exclusions and conditions. If there is any ambiguity as between the terms of the Policy with respect to coverage in the event of confiscation, etc., the Policy should be so construed as to effectuate the purpose of indemnification against loss, rather than to defeat it. *Southern Farm Bureau Cas. Ins. Co. v. Adams,* 570 S.W. 2d 567, 570 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.); *Central Sur. & Ins. Corp. v. Anderson,* 446 S.W. 2d 897, 903 (Tex. Civ. App.—Fort Worth 1969, no writ); *St. Paul Mercury Ins. Co. v. Sugarland Industries. Inc.,* 406 S.W. 2d 778, 781 (Tex. Civ. App.—Eastland 1966, writ ref'd n.r.e.); *Jones v. Mutual Liability Ins. Co. of Wis.,* 336 S.W. 2d 905, 907 (Tex. Civ. App.-Eastland 1960, writ ref'd).

By the Lease's terms, GECC was seeking protection for risks under the War Risk Endorsement. Under Texas law, insurance contracts must be liberally construed in favor of a policy holder or beneficiary thereof, wherever possible, and strictly construed against the insurer in order to afford the protection which the insured was endeavoring to secure when he applied for the insurance. *Republic Nat'l Life Ins. Co. v. Heyward,* 536 S.W. 2d 549, 557 (Tex. 1976); *Providence Washington Ins. Co. v. Profitt,* 239 S.W. 2d 379, 381 (Tex. 1951).

The Texas Supreme Court *restated* the key rule of construction applicable to our case, which has been disregarded by the Courts, in *National Union Fire Ins. Co. v. Hudson Energy Co.,* 811 S.W.2d 552, 555 (Tex. 1991). The Texas Supreme Court held as follows:

> However, if a contract of insurance is

> susceptible of more than one reasonable interpretation, we must resolve the uncertainty by adopting the construction that most favors the insured. *Barnett,* 723 S.W.2d at 667; *Ramsay v. Maryland Am. Gen. Ins. Co.,* 533 S.W.2d 344, 349 (Tex. 1976); *Brown v. Palatine,* 89 Tex. 590, 35 S.W. 1060, 1061(1896). The court must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent. *Glover v. Nat'. Ins. Underwriters,* 545 S.W.2d 755, 761 (Tex. 1977); *Continental Casualty Co. v. Warren,* 152 Tex. 164, 254 S.W.2d 762, 763 (1953). In particular, exceptions or limitations on liability are strictly construed against the insurer and in favor of the insured. *Ramsay,* 533 S.W.2d at 349; *Continental,* 254 S.W.2d at 763. *See also Roval Indem. Co. v. John F. Cawrse Lumber Co.,* 245 F.Supp. 707 (D.C. Or. 1965).

Thus, under Texas law, the provisions of the War Risk Endorsement, when read with the conflicting limitations of the Breach of Warranty Endorsement, must be construed so as to recognize coverage for GECC when there has been a confiscation of the Aircraft, regardless of whether the Aircraft was converted.

*D. The District Court Missed the Point*

The District Court in its Memorandum Opinion and Order (App. C) addressed Petitioners' argument by concluding that inasmuch as the Breach of Warranty Endorsement is a separate

contract from the Policy and GECC derived its rights from the Breach of Warranty Endorsement, Petitioners could not claim the benefit of an inclusion in the Policy, but which was not also in the Breach of Warranty Endorsement.

Petitioners contend that the District Court did not appreciate the true effect of the Breach of Warranty Endorsement. That is, Petitioners contend that the District Court has read more into the effect of a breach of warranty endorsement on the Policy's terms than what the Texas courts have held. Breach of warranty endorsements are *separate* contracts under Texas law. Such endorsements are patterned after union or standard mortgage clauses and create an independent or separate contract between the insurance company and the defined lienholder. *St. Paul Fire & Marine Ins. Co. v. Crutchfield,* 350 S.W. 2d 534, 537 (Tex. 1961); *Citizens State Bank v. American Fire & Casualty Co.,* 198 F.2d 57, 60 (5th Cir. 1952); 10A Rhodes, *Couch on Insurance 2d* 42, 728. Standard mortgage clauses and breach of warranty clauses provide that insurance, as to the interest of the mortgagee only, shall not be invalidated by any act or neglect of the named insured. Thus, the mortgagee is freed from most policy defenses which may be available against the named insured. *Don Chapman Motor Sales Inc. v. National Savings Ins. Co.,* 626 S.W. 2d 592, 595 (Tex. Civ. App.—Austin 1982, writ ref'd n.r.e.), *quoting* 5A J. Appleman, *Insurance Law and Practice* 3401.

In *Travelers Indemnity Co. v. Storecraft, Inc.,* 491 S.W. 2d 745 (Tex. Civ. App.—Corpus Christi 1973, no writ), that court summarized the basic law, as follows:

> The effect of the Mortgage Clause, when incorporated in the policy, is to make a new and independent contract between the mortgagee and the insurer that insures separately the mortgagee's interest in the property that was

> insured in the contract between the owner-mortgagor and the insurance company. The case of *Rio Grande Nat. Life Ins. Co. v. Hardware Dealers Mut. Fire Ins. Co.*, 209 S.W.2d 654 (Tex. Civ. App.—Amarillo 1948, writ ref'd n.r.e.) is directly in point; *Camden Fire Ins. Ass'n v. Harold E. Clayton & Co.*, 117 Tex. 414, 6 S.W.2d 1029 (1928) is cited by that court as authority for that holding. Being a separate insurance contract on the mortgagee's interest, its validity is dependent solely on the acts of the mortgagee, and is not affected or invalidated by any act or neglect of the mortgagor in violation of the terms and conditions of the policy that are unknown to the mortgagee.

Accordingly, "[i]t is settled law in Texas that a standard mortgage clause . . . is valid and enforceable in accordance with its express terms . . . . Its effect is to make an independent contract between the mortgagee and the insurance company." *Lexington Ins. Co. v. Gray*, 775 S.W. 2d 679, 683 (Tex. App.—Austin 1989, writ denied) (fire insurance).

When Texas courts hold that a breach of warranty (or standard mortgage) clause creates a separate insurance contract between the parties thereto, the effect of the new contract is that its validity is dependent solely upon the acts of its beneficiary and is not affected or invalidated by any act or neglect of the insured. However, that is not to say that the new contract negates coverage within the basic policy. *Piedmont Fire Ins. Co. v. Fidelity Mortgage Co.*, 250 Ala. 609, 35 So. 2d 352 (Ala. 1948); 43 Am. Jur. 2d, *Insurance*, 1045, p. 1046. When the courts note that a breach of warranty endorsement creates a separate contract, they are not holding that the terms and provisions of the basic contract are abandoned, but rather, the same

terms and provisions apply, absent those conditions, covenants and exclusions within the basic policy which would otherwise affect or invalidate coverage as to the insured therein. However, those provisions in the basic policy which *provide coverage* or which *extend coverage* remain part of the terms of the separate contract. As held in *Piedmont Fire Ins. Co.*, 35 So. 2d at 353:

> The loss payable clause in this case is what is known as the union or standard mortgage clause. The effect of such a clause is to make a separate and independent contract between the mortgagee and the insurer and to effect a separate insurance on the mortgagee's interest. *Liverpool & London & Globe Ins. Co. v. Dickinson*, 242 Ala. 107, 5 So.2d 90. *However, the terms of the contract between the insurer and the mortgagee are to be rendered certain and understood by reference to the policy. Reed v. Firemen's Ins. Co.*, 81 N.J.L. 523, 80 A. 462, 35 L.R.A., N.S., 343, 29 Am.Jur. p. 448. For example resort may be had to the provisions of the policy to ascertain, among other things, the property insured, the amount, rate *and terms of the policy. Trust Co. of St. Louis County v. Phoenix Ins. Co.*, 201 Mo.App. 223, 210 S.W.98; 124 A.L.R. 1044. (emphasis supplied)

Thus, the extended coverage provided in the War Risk Endorsement is as much a part of the separate contract created by the Breach of Warranty Endorsement between GECC and National Union as the other provisions in the Policy providing coverage.

### *E. The Conversion Limitation Within the Breach of Warranty Endorsement is Not an Exclusion*

More fundamentally, the Courts erred by concluding that the provision of the Breach of Warranty Endorsement was a "conversion *exclusion.*" As it is written, the provision is not an *exclusion.* The provision provides, "but conversion, embezzlement, or secretion by or at the direction of the Named Insured *is not covered herein.*" (App. E). An exclusion operates to suspend coverage as long as the excluding event remains, regardless of the nature or cause of loss. There is no need to establish any causal connection between the loss and the excluding event.

There is no such implication arising from the conversion limitation in the Breach of Warranty Endorsement. The above language only provides that Physical Damage Coverage under the Breach of Warranty Endorsement does not include coverage for conversion by or at the direction of the Named Insured. Under general principles of insurance law, an exclusion is distinguishable in its effect from either a limitation on coverage or an exception. *See* R. Keeton and A. Widiss, *Insurance Law, A Guide to Fundamental Principles, Legal Doctrines and Commercial Practices,* Student Edition 1988, § 5.5(a)(3), (4), pp. 547.[2] The

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2. "Insurance contract terms may also be categorized or analyzed in terms of whether the declared effect of a provision is conclusive against coverage (an exclusion in Patterson's terminology) or instead is inconclusive in that it is merely a declaration that a certain kind of cause of loss is not an affirmative basis of recovery (an exception in Patterson's terminology), leaving open the possibility of some other basis for recovery . . . .

*See also* 2 Richards, *Law of Insurance* (5th Ed., Freedman, 1952), at 208:

(Cont'd)

Courts erred in concluding that if there was a conversion by the Named Insured, such was an exclusion requiring suspension of coverage for all subsequent losses. Rather, properly construed, the Breach of Warranty Endorsement only provides that there is no coverage for Physical Damage directly caused by a conversion by the Named Insured; however, if the loss is directly caused by another event (*i.e.*, confiscation), there is coverage.[3]

*Pan American World Wide Airways, Inc. v. Aetna Cas. & Sur. Co.*, 505 F.2d 989, 1006-7 (2d Cir. 1974) addresses causation in this sense.

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(Cont'd)

> An Excepted Cause or Exception Clause generally provides that an insurer is not liable for loss or damage if the Insured Event actually resulted from or was caused by the subject matter of the Excepted Cause or Exception Clause * * *. The Exclusion Clause simply excludes from coverage certain events which otherwise would fall within the scope of the Insured Event."

3. *See* Insurance Law *supra* at 5.5(c), p. 553 n 2:

> When an insurance policy provides coverage for losses produced by some causes and excludes coverage for losses from other causes, courts frequently hold that coverage extends to the loss even though an excluded element is a contributory cause. n.2

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2. See, e.g., General American Transportation Corporation v. Sun Insurance Office, Ltd., 369 F.2d 906 at pp. 906-908 (6th Cir. 1966), adopting the rule from the decision in Fireman's Fund Insurance Co. v. Hanley, 252 F.2d 780 at p. 785 (6th Cir. 1958).

Also see Dow Chemical Company v. Royal Indemnity Company, 635 F.2d 379 at p. 391 (5th Cir., Unit A 1981); Essex House v. St. Paul Fire & Marine Insurance Company, 404 F.Supp. 978 (S.D.Ohio 1975).

Cf. Auto Owners Insurance Company v. Allen, 362 So.2d 176 (Fla.App. 2d Dist. 1978).

> Remote causes of losses are not relevant to the characterization of an insurance loss. In the context of this commercial litigation, the *causation inquiry stops at the efficient physical cause of the loss;* it does not trace events back to their metaphysical beginnings. *The words 'due to or resulting from' limit the inquiry to the facts immediately surrounding the loss.* Standard Oil Co. v. United States, 340 U.S. 54, 58, 71 S.Ct. 135, 95 L.Ed 68 (1950); Airlift International, Inc. v. United States, 335 F.Supp. 442, 449 (S.D.Fla.1971), affd, 460 F.2d 1065 (5th Cir. 1972) (mem.). Thus, in Queen Insurance Co. v. Globe & Rutgers Fire Insurance Co., 263 U.S. 487, 492, 44 S.Ct. 175, 176, 68 L.Ed 402 (1924), Mr. Justice Holmes wrote:
>
> > "[T]he common understanding is that in construing these policies we are not to take broad views but generally are to stop our inquiries with the cause nearest to the loss . . . ."

Contraras's misuse of the Aircraft resulted in its confiscation and the *confiscation* was the efficient, physical cause of the loss—the cause nearest the loss. Such loss was not caused by the subletting of the Named Insured.

### *F. The Proper Meaning of the Policy by the Interplay of the Two Endorsements*

In reaching its opinion (App. A), the Court of Appeals followed the District Court's analysis (App. C, D), again without any regard for the precedent set forth by the Texas Supreme Court. The Court of Appeals held in effect that the War Risk Endorsement

was subject and subordinate to the "conversion exclusion" set forth in the Breach of Warranty Endorsement. Such contention is not based on a proper construction of the Policy's terms. The Breach of Warranty Endorsement must be read in the context of the entire Policy, including the specific language in the War Risk Endorsement providing that "notwithstanding anything in the policy to the contrary," there was coverage in the event of confiscation of the Aircraft. The language in the War Risk Endorsement is no less important or significant than the language in the Breach of Warranty Endorsement in construing the Policy as to the issue of coverage for GECC as lienholder. A standard breach of warranty endorsement is generally construed to mean that as respects the lienholder, the coverage of the policy pertains notwithstanding covenants or exclusions to which the *insured* is subject under the terms of the Policy. That is, with respect to the lienholder, the terms of the Policy apply as a separate contract notwithstanding the fact that the insured may not have coverage by reason of the underlying Policy's terms. However, to say that the Breach of Warranty Endorsement creates a separate contract is not dispositive as to the proper construction of the terms of the separate contract (*i.e.*, the interplay of the endorsement's terms with the other terms of the Policy).

National Union reached its conclusion as to the proper meaning of the Policy by construing the Policy out of whole cloth so as to narrow the War Risk Endorsement's applicability. One fundamental premise of National Union's argument is that the "notwithstanding" clause within the War Risk Endorsement is only in reference to paragraphs 6(d) and 6(e) of the Policy (which expressly excluded such coverage), "because those two paragraphs are the only paragraphs that are contrary to the terms of the War Risk Endorsement. (*See* Brief of Appellee, p. 15.) However, the language in the War Risk Endorsement provides "notwithstanding *anything* in the policy to the contrary"; it does not provide, "notwithstanding paragraphs 6(d) and 6(e) of the policy." To accept National Union's argument that the War Risk

Endorsement was *only to add coverage* for its specified risks, which were otherwise expressly not covered by the Policy (*see* Par. 6(d) and (e) of the Exclusions of the Policy), the War Risk Endorsement would have read, "subject to the provisions of the policy."

The proper construction of the notwithstanding clause of the War Risk Endorsement must be that any provision, exclusion or limitation in the Policy which would deny, limit or exclude coverage for the specified risks in the War Risk Endorsement would be *contrary* to the extended coverage of the War Risk Endorsement with *its own special exclusions.*

Consideration of the War Risk Endorsement in another context points out its effect on the terms of the Policy. If one addresses the terms of coverage as it applies to the *insured,* the language of the War Risk Endorsement meant that notwithstanding any provisions in the Policy which would otherwise exclude or limit coverage, the Policy nevertheless provides coverage in the event the specified risks in the War Risk Endorsement occur. For instance, the War Risk Endorsement's coverage prevails over the conversion exclusion within the Policy as to the insured. (*See* Par. 6(a) of the Exclusions of the Policy.) That is, the Policy (Par. 6(a)) provides that conversion of the Aircraft results in exclusion of coverage to the *insured.* The interplay of the language in the War Risk Endorsement with the general limitations and exclusions in the Policy is that notwithstanding any of the exclusions in the Policy, the endorsement provides coverage to the insured in the event of the confiscation of the Aircraft. If the parties' intentions were simply to add such additional risks as enumerated in the War Risk Endorsement to the other coverage in the Policy, such would have easily been accomplished by adding an endorsement covering such additional risks "*subject to* the terms of the Policy." If such was the parties' intention, there would have been no need to include the introductory clause "notwithstanding anything in the

policy to the contrary" or to include a special "Exclusion" section within the War Risk Endorsement.

Likewise, when one considers the "separate" contract between the lienholder and National Union, by reading the Policy as a whole, it is clear that the War Risk Endorsement means that "notwithstanding anything in the policy to the contrary," (which necessarily includes the "exclusions" set forth in the Breach of Warranty Endorsement), should any of its specific risks occur (*i.e.*, confiscation, seizure of the Aircraft), the Policy provides coverage. In this regard, the War Risk Endorsement had its own special exclusions set forth in its Section 4; those were the *only* exclusions which applied in the event that any of the specific risks in the War Risk Endorsement occurred.

Unlike the War Risk Endorsement, there was no clause in the Breach of Warranty Endorsement providing: "notwithstanding anything in the policy to the contrary." The Breach of Warranty Endorsement is *part of* the Policy; that part of the Policy which addresses the insurance contract between National Union and GECC as the lienholder, but the terms of that separate contract includes the remainder of the Policy. If it was the intention of the parties that the Breach of Warranty Endorsement's provisions were to prevail over all other provisions in the Policy *as respects the lienholder,* the parties would have included a clause in the Breach of Warranty Endorsement providing "notwithstanding anything in the Policy and the War Risk Endorsement to the contrary, if there is a conversion of the Aircraft by or at the direction of the Named Insured, there is no coverage." That, however, is not how the Breach of Warranty Endorsement reads, and when one reads the *Policy as a whole,* it is clear that the War Risk Endorsement's provision of "notwithstanding anything in the policy to the contrary" was *intentionally included* to prevail over *any* contrary conditions or exclusions in the Policy, including those in the Breach of Warranty Endorsement.

It is also proper to consider the surrounding circumstances when one seeks to properly construe the Policy. *City of Pinehurst v. Spooner Addition Water Co.*, 432 S.W. 2d 515 (Tex. 1968). By reviewing the language of the entire Policy, in light of its intended purposes and surrounding circumstances, it should be noted that GECC specifically required War Risk Endorsement coverage in addition to Breach of Warranty Endorsement coverage in its lease with Care Flight. The War Risk Endorsement was not included at Care Flight's insistence, but rather, the War Risk Endorsement was required to be included in the Policy by reason of GECC's lease requirement that such coverage be provided. GECC's intentions, as lienholder, in requiring a War Risk Endorsement, was to insure that in the event of certain specified risks occurring (*i.e.*, confiscation and seizure of the Aircraft), there would be coverage regardless of the conditions and exclusions in the Policy. GECC was doing so to insure that *GECC*, as lienholder, would be covered in the event such specified risks occurred. National Union's argument that the "notwithstanding" clause in the War Risk Endorsement was only in direct reference to paragraphs 6(d) and 6(e) of the basic Policy flies in the face of the fact that the War Risk Endorsement was required *by GECC* in its lease of the Aircraft for its protection, not its lessee's. When one considers the "notwithstanding" clause within the War Risk Endorsement in light of GECC's also requiring a Breach of Warranty Endorsement, one can see that GECC's intention was to have coverage as lienholder if such specified risks occurred, "notwithstanding any in the policy to the contrary," especially including any exclusions in the Breach of Warranty Endorsement.

## CONCLUSION

In conclusion, the Court of Appeals' construction of the Policy is only achievable if the Court of Appeals is allowed to either negate or limit the meaning of the clause "notwithstanding anything in the policy to the contrary" set forth in the beginning of

the War Risk Endorsement. A reasonable construction of the Policy is that there was special coverage for GECC in the event the Aircraft was confiscated. The Court of Appeal's construction disregards significant provisions of the Policy and ignores the surrounding circumstances. However, for the Court of Appeals to argue that it can make another "reasonable" interpretation of the Policy in its Opinion, does not address and fails to negate Petitioners' reasonable construction. In such case, under Texas law, Petitioners' reasonable construction, as insureds, must prevail. The Court of Appeals erred by failing to apply fundamental Texas law as enunciated by the Texas Supreme Court in *National Union v. Hudson, supra.* The *Erie* doctrine definitely comes into play in this action; and unless this Court exercises its power of supervision to redress this departure from state law and to once again bring home to the federal judiciary that the *Erie* doctrine is to be strictly observed, the doctrine will become just so many words and diversity jurisdiction becomes a tool to evade the even application of state law to all parties.

Petitioners move that this Supreme Court grant the Petition for Writ of Certiorari, reverse the Judgments of the Courts, and for such other and further relief, both general and special, at law or in equity, to which Petitioners may show themselves justly entitled.

Respectfully submitted,

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## APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS AT 18 F.3d 323 (5th Cir. 1994)

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,
Plaintiff-Appellee-Cross-Appellant,

v.

CARE FLIGHT AIR AMBULANCE SERVICE, INC., ET AL.,
Defendants-Appellees,

General Electric Capital Corp. and Avemco Insurance Co.,
Defendants-Appellants-Cross-Appellees.

No. 93-1154.

United States Court of Appeals,
Fifth Circuit.

April 12, 1994.

* * *

Appeals from the United States District Court for the Northern District of Texas.

Before REAVLEY and DAVIS, Circuit Judges, and ROSENTHAL,* District Judge.

ROSENTHAL, District Judge:

On March 3, 1989, General Electric Capital Corporation,

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* District Judge of the Southern Distnct of Texas, sitting by designation.

*Appendix A*

("GECC"), leased a Piper Cheyenne 400LS aircraft to Care Flight Air Ambulance Service, Inc. ("Care Flight"). The lease prohibited Care Flight from subleasing the aircraft without GECC's consent, and required Care Flight to insure the plane. On March 5, 1989, Care Flight obtained an insurance policy from National Union Fire Insurance Co. of Pittsburgh, PA. ("National Union"). The policy contained a war risk endorsement and a breach of warranty endorsement. The breach of warranty endorsement named GECC as a beneficiary along with the named insured, Care Flight. The breach of warranty endorsement contained a clause excluding coverage for loss due to conversion by or at the direction of the named insured. GECC's interest in the plane was insured by AVEMCO.

Without seeking authorization from GECC, Care Flight subleased the aircraft to James Coltharp ("Coltharp"), an admitted violation of the lease. Coltharp in turn subleased it to Anthony Contraras ("Contraras"). There was a dispute in the summary judgment evidence as to whether Care Flight participated in or knew of this sublease to Contraras. It is undisputed that Contraras flew the plane to several Central American countries, and that while the aircraft was in Contraras's possession, the Colombian government seized the plane for violation of Colombian air traffic laws.

GECC was notified by Care Flight on September 1, 1989 that the aircraft had been confiscated. The aircraft was not returned to the United States until almost three years later. Before the plane was returned, AVEMCO paid GECC, its insured, $2.5 million for the plane. Asserting subrogation rights, AVEMCO demanded that National Union pay AVEMCO under National Union's policy with Care Flight. National Union then filed this declaratory relief action and moved for summary judgment that coverage was precluded because Care Flight had converted the plane.

*Appendix A*

The district court granted summary judgment in favor of National Union, ruling that Care Flight had converted the aircraft as a matter of law and that the conversion limitation in the breach of warranty endorsement precluded coverage. Final judgment was entered on February 16, 1993.

In this appeal, GECC and AVEMCO assert that the district court erred in finding that Care Flight had converted the plane and in holding that the conversion limitation in the breach of warranty endorsement precluded coverage. National Union cross-appealed from the district court's refusal to award part of National Union's attorneys' fees incurred in its dispute with GECC and AVEMCO.

I. Standard of Review

This court reviews summary judgments *de novo. Fireman's Fund Ins. Co. v. Murchison,* 937 F.2d 204, 207 (5th Cir.1991); *Mozeke v. International Paper Co.,* 856 F.2d 722, 725 (5th Cir.1988). The issue before this court is whether any questions of material fact exist that bar the moving party from judgment as a matter of law. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323-25, 106 S.Ct. 2548, 2552-54, 91 L.Ed.2d 265 (1986); *American Economy Ins. Co. v. Tomlinson,* 12 F.3d 505, 507 (5th Cir.1994). In making this determination, this court must view all fact questions in the light most favorable to the nonmovant. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 255, 106 S.Ct. 2505, 2513, 91 L.Ed.2d 202 (1986); *United States v. Park Towers, Inc.,* 8 F.3d 306, 309 (5th Cir.1993). This court reviews matters of contract interpretation *de novo. Travelers Ins. Co. v. Liljeberg Enterprises, Inc.,* 7 F.3d 1203,1206 (5th Cir.1993); *Matador Drilling Co. v. Post,* 662 F.2d 1190, 1197 (5th Cir.1981).

*Appendix A*

II. The Relevant Policy Language

National Union's policy contained a breach of warranty endorsement insuring against physical damage to the aircraft. The endorsement provided in part as follows:

> 1. As to the interest of the said Lienholder only, the Insurance afforded by any Physical Damage Coverage of this policy shall not be invalidated by any act or neglect of the Named Insured nor by any change in the title or ownership of the aircraft but conversion, embezzlement or secretion by or at the direction of the Named Insured is not covered hereunder; provided however that:
>
> > (a) in case the Named Insured shall neglect to pay any premium due under this policy the Lienholder shall, on demand, pay the premium; and
> >
> > (b) the Lienholder shall notify the Company of any change of title or ownership of the aircraft or apparent increase of hazard, which shall come to the knowledge of the Lienholder, and, unless permitted by this policy, it shall be endorsed thereon and the Lienholder shall, on demand, pay the premium for such increased hazard.

(III R. 35).

Page 2 of the main body of the insurance policy contained the

policy's coverage exclusion. Paragraph 6(a) of the policy excluded from coverage "loss or damage due to conversion . . . by any person in possession of the aircraft under a bailment, lease . . . or other encumbrance." (III R. 25).

The policy also included a war risk endorsement, which provided that "notwithstanding anything in the policy to the contrary," the policy covered physical loss of or damage to the aircraft if caused by "[c]onfiscation, nationalisation [sic], seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any Government." (III R. 31). Both the breach of warranty endorsement and the war risk endorsement stated that "[n]othing herein contained shall vary, alter, waive or extend any of the terms, provisions, representations, conditions or agreements of the policy other than as above stated." (III R. 31, 35)

III. Conversion As a Matter of Law

The district court found that the unauthorized sublease, resulting in the confiscation, was a conversion as a matter of law. Texas law defines conversion as "the unauthorized and unlawful exercise of dominion and control over property inconsistent with or to the exclusion of another's superior rights in that property." *Vickery v. Texas Carpet Co.*, 792 S.W.2d 759, 762 (Tex.App. — Houston [14th Dist.] 1990, writ denied); *Waisath v. Lack's Stores, Inc.*, 474 S.W.2d 444, 446 (Tex.1971). Under Texas law, wrongful intent is not an element of conversion. *Killian v. Trans Union Leasing Corp.*, 657 S.W.2d 189 (Tex.App. — San Antonio 1983, writ ref'd n.r.e.). GECC and AVEMCO claim that because Care Flight's conduct breached its lease contract, such conduct cannot as a matter of law constitute the tort of conversion.

Texas law has long distinguished tort liability from contract liability as between the parties to a contract, seeking to avoid the

availability of both tort and contract liability for the same conduct and the same kind of harm or loss. *See Southwestern Bell Telephone Co. v. DeLanney,* 809 S.W.2d 493 (Tex. 1991); *Jim Walter Homes, Inc. v. Reed,* 711 S.W.2d 617 (Tex.1986); *Mid-Continent Aircraft Corp. v. Curry County Spraying Service Inc.,* 572 S.W.2d 308, 312 (Tex.1978). However, the Texas cases also recognize that when certain legal relationships exist between contracting parties, the law may impose affirmative duties that are separate and apart from the contractual promises made between those parties. To determine whether conduct that breaches a contract can also be a tort, Texas law requires a court to look to the origin of the duty owed and the nature of the resulting injury. 809 S.W.2d at 494-95.

In *Southwestern Bell Telephone Co. v. DeLanney,* the Texas Supreme Court described the relevant inquiry into the origin of the duties owed, as follows:

> As one prominent authority has explained: "Tort obligations are in general obligations that are imposed by law — apart from and independent of promises made and therefore apart from the manifested intention of the parties — to avoid injury to others." W. Keeton, D. Dobbs, R. Keeton & D. Owen, *Prosser and Keeton On the Law of Torts* § 92 at 655 (5th Ed.1984).... If the defendant's conduct — such as negligently burning down a house — would give rise to liability independent of the fact that a contract exists between the parties, the plaintiff's claim may also sound in tort. Conversely, if the defendant's conduct — such as failing to publish an advertisement — would give rise to

> liability only because it breaches the parties' agreement, the plaintiff's claim ordinarily sounds only in contract.

809 S.W.2d at 494.

In *Southwestern Bell v. DeLanney,* the plaintiff sued over Southwestern Bell's breach of its promise to print plaintiff's advertising in the "yellow pages." The Texas Supreme Court examined the origin of the duties between the parties and found that the only duty breached arose from the contract itself. The court held that the plaintiff therefore had no tort claim.

In this case, Care Flight owed GECC a contractual duty not to sublease the aircraft without GECC's consent. However, under the Texas law of bailment, Care Flight also owed GECC a tort-based duty not to exercise unauthorized dominion and control over the leased plane inconsistent with, or to the exclusion of, GECC's superior rights in the plane. *Vickery,* 792 S.W.2d at 762. Care Flight's unauthorized sublease of the plane to Coltharp was admittedly a breach of the contract. The issue is whether it also breached Care Flight's separate and independent obligation originating under the Texas tort law of conversion.

Texas courts have specifically recognized that because the law of conversion and bailment imposes legal duties outside any contractual agreements, separate causes of action for breach of contract and conversion may arise from the same facts. For example, in *Vickery,* 792 S.W.2d at 762-63, the court held that a breach of contract and a conversion claim both arose when the defendants failed to pay an invoice for goods delivered and kept the goods. Similarly, in *Allied Bank of Texas v. Plaza DeVille Assoc.,* 733 S.W.2d 566 (Tex.App. — San Antonio 1987, writ ref'd n.r.e.), the court held that the defendant's wrongful withholding of

rental proceeds constituted a conversion; in *High Plains Wire Line Services Inc. v. Hysell Wire Line Service, Inc.*, 802 S.W.2d 406, 410 (Tex.App. — Amarillo 1991, no writ), the court found for conversion arising out of an alleged breach of a purchase agreement; and in *Virgil T. Walker Const. Co., Inc. v. Flores*, 710 S.W.2d 159 (Tex.App. — Corpus Christi 1986, no writ), the court found a claim for conversion and a claim for breach of contract from a failure to relinquish control over construction machinery after a sale.

Appellants do not dispute that under Texas law, a claim for breach of contract and the tort of conversion can arise from the same facts. Appellants argue that there cannot be a separate tort here because the lease between GECC and Care Flight abrogated the rights and duties arising under the common law of conversion and bailment.

Appellants cite *Anchor Casualty Co. v. Robertson Transport Co.*, 389 S.W.2d 135, 138 (Tex.Civ.App. — Corpus Christi 1965, writ ref'd n.r.e.), for the proposition that parties may, by express contract, "enlarge, abridge, qualify or supersede the obligations which otherwise would arise from the bailment by implication of the law." *Id.* (citations omitted). *Anchor Casualty* involved collision insurance for the protection of a leased truck. The parties to that lease agreed that the lessee would not be liable for any loss to the truck, and the court relied on the parties' mutual understanding of the lease agreement in denying subrogation rights. 389 S.W.2d at 139. By contrast, the lease in this case expressly placed the entire risk of loss on Care Flight, the lessee, (III R. 153), and provided that "[n]o remedy referred to herein is intended to be exclusive, but each shall be cumulative and *in addition to any other remedy referred to above or otherwise available to Lessor at law or in equity,*" (III R. 156) (emphasis added). Rather than expressly abrogating the rules of tort liability,

or the duties imposed through the law of bailment, the lease at issue here retained the lessor's right to assert all common law remedies.

In addition to looking to the origin of the duties, the Texas courts also look to the nature of the injury to determine whether a claim is for contract, tort, or both. The general rule is that where a defendant's conduct breaches an agreement between the parties and does not breach an affirmative duty imposed outside the contract, the plaintiff ordinarily may not recover on a tort claim if the damages are economic losses to the subject matter of the contract. *Jim Walter Homes, Inc. v. Reed,* 711 S.W.2d 617, 618 (Tex.1986).

GECC and AVEMCO assert that the conduct here not only violated duties imposed outside the contract, but also caused injuries that go beyond economic losses to the subject matter of the contract. They point to the loss of use of the aircraft for over three years, well beyond the four-month lease term, and the repair costs for the damage the aircraft received during the unauthorized sublease and confiscation.

The Texas cases clearly hold that a plaintiff asserting negligent failure to perform a contract does not have a tort cause of action when the only injury is economic harm to the subject of the contract itself. *Jim Walter Homes,* 711 S.W.2d at 618.[1] By contrast,

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1. The Texas cases have sharply divided as to whether there must be proof of tort damages separate and independent From damages for breach of contract when the conduct violates duties independent of the contract. *See, e.g., Prudential Insurance Co. v. Jefferson Associates, Ltd.,* 839 S.W.2d 866, 876 (Tex.App. — Austin 1992, writ granted) (damages for conduct that is both fraud and a breach of contract are recoverable even though the measure of damages is the same for the tort and the breach of contract), *Schindler v. Austwell Farmers Cooperative,* 829 S.W.2d 283,

(Cont'd)

the Texas courts have consistently found claims for both conversion and breach of contract based on a single set of facts and a single injury. *See Vickery,* 792 S.W.2d at 762; *Plaza National Bank v. Walker,* 767 S.W.2d 276 (Tex.App. — Beaumont 1989, writ denied); *Allied Bank,* 733 S.W.2d at 566; *see also, Ames v. Great Southern Bank,* 672 S.W.2d 447 (Tex.1984); *Prewitt v. Branham,* 643 S.W.2d 122 (Tex.1982). The Texas courts have not held that in order to allege both a breach of contract and the tort of conversion, the conversion damages must be separate and distinct from the contract damages.

Given the record before this court and the Texas law, the district court correctly found that the fact that Care Flight breached its lease contract did not preclude a finding that Care Flight also committed the tort of conversion.

The district court was also correct in holding that Care Flight's initial lawful possession of the plane by Care Flight did not

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(Cont'd)

290-91 (Tex.App. — Corpus Christi), *aff'd as modified on other grounds,* 841 S.W.2d 853 (Tex.1992) (no requirement that damages independent from the injuries for breach of contract must be proven to recover for fraud); *but see Barbouti v. Munden,* 866 S.W.2d 288, 293-94 (Tex.App. — Houston [14th Dist] 1993, writ filed) (a fraud cause of action will not arise where the only damages are for breach of the contract); *Central Savings & Loan Assoc. v. Stemmons Northwest Bank,* 848 S.W.2d 232 (Tex.App. — Dallas 1992, no writ) (a cause of action sounds in contract and not tort where the only injury is economic loss to the subject matter of contract); *Hebisen v. Nassau Development Co.,* 754 S.W.2d 345, 348 (Tex.App. — Houston [14th Dist.] 1988, writ denied) (even if the breach of a lease is also the tort of fraud, there is no claim for fraud if the only damages are failure to pay the basic amounts); *see also C & C Partners v. Sun Exploration & Production Co.,* 783 S.W.2d 707, 719-20 (Tex.App. — Dallas 1989, writ denied) (recovery for both fraud and breach of contract is precluded by a failure to prove actual damages arising from the tort). The Texas Supreme Court has not resolved this conflict.

preclude a finding of conversion. "One who is authorized to make a particular use of a chattel, and uses it in a manner exceeding the authorization, is subject to liability for conversion to another whose right to control the use of the chattel is thereby seriously violated." *Restatement (Second) of Torts* § 228, (1965). Texas generally follows the elements of conversion as stated in the *Restatement,* which provides that "[t]he limits of the permitted use ordinarily are determined by the terms, express or reasonably implied, of the contract or other agreement between the parties, and the question becomes one of whether there is a material breach of the agreement." *Id.* at Cmt. C.

The district court correctly determined that the unauthorized sublease of the aircraft was a material breach. Texas law recognizes the distinction between serious violations of another's right of control, which constitute conversion, and minor or technical violations insufficient in degree of interference to constitute conversion.

The several reported cases on point are all consistent with this result. In *Sunsh. Mfg. Southeast v. Manhattan Fire & Marine Ins.*, 675 F.2d 1218 (11th Cir.1982), the Eleventh Circuit held that a conversion exclusion in an insurance policy precluded coverage where a leased aircraft was used to transport marijuana, in violation of the lease agreement and was subsequently confiscated by the Bahamian government. 675 F.2d at 1219. Relying on § 228 of the *Restatement,* the court concluded that, under Georgia law, the conversion exclusion applied. *Id.* at 1220. The applicable Georgia law was the same in relevant respects as Texas conversion law. *See also, National Union Fire Ins. Co. v. Carib Aviation, Inc.*, 759 F.2d 873 (11th Cir.1985); *Gelder v. Puritan Ins. Co.*, 100 N.M. 240, 241, 668 P.2d 1117, 1118 (1983).

Appellants' assertion that there could be no conversion

because National Union made no formal demand is not supported by Texas law. Formal demand and refusal are not necessary if demand would be useless, or "if the possessor's acts amount to a clear repudiation of the owner's rights." *Bures v. First National Bank, Port Lavaca,* 806 S.W.2d 935 (Tex.App. — Corpus Christi 1991); *see also Permian Petroleum Co. v. Petroleos Mexicanos,* 934 F.2d 635, 651 (5th Cir.1991). Demand and refusal are not necessary if other proof demonstrates a conversion. *Presley v. Cooper,* 155 Tex. 168, 284 S.W.2d 138, 141 (1955).

It is undisputed that the aircraft at issue was confiscated by the government of Colombia. GECC's formal demand to Care Flight to return the aircraft would have been useless. Moreover, there was other proof that a conversion occurred so that demand and release were not necessary as a matter of law. *Presley,* 284 S.W.2d at 141.

The district court's summary judgment that Care Flight converted the aircraft is affirmed.

IV. Coverage Under the Policy

Appellants challenge the district court's holding that the exception to the breach of warranty endorsement for conversion precluded coverage under the policy. Appellants argue that the war risk endorsement extended coverage for losses caused by a confiscation.

Under Texas law, insurance contracts are subject to the same rules of interpretation that govern other contracts. *Forbau v. Aetna Life Ins. Co.,* __ S.W.2d , __,1994 WL 2810 at * 1, 1994 Tex. LEXIS 14 at * 4 (January 5, 1994); *Upshaw v. Trinity Cos.,* 842 S.W.2d 631, 633 (Tex.1992). The interpretation of a contract, including the question of whether or not a contract is ambiguous, is

a legal determination to be made by a court. *National Union Fire Ins. Co. v. Kasler Corp.*, 906 F.2d 196 (5th Cir.1990); *Praeger v. Wilson*, 721 S.W.2d 597 (Tex.App. — Fort Worth 1986, writ ref'd n.r.e.). The court's primary concern is to give effect to the written expression of the parties' intent. *Forbau*, __ S.W.2d at __, 1994 WL 2810 at * 1, 1994 Tex. LEXIS 14 at * 4. The court shall read "all parts of the contract together to ascertain the agreement of the parties." *Id.* A court should interpret a contract so that each provision of the contract is given effect. *Id.*

The war risk endorsement to the policy between National Union as insurer and Care Flight as insured stated that "notwithstanding anything in the policy to the contrary . . . [there is coverage for] confiscation . . . by any Government." (III R. 31). The war risk endorsement continues: "Nothing herein contained shall vary, alter, waive or extend any of the terms, provisions, representations, conditions or agreements of the policy other than as above stated." *(Id.)*[2]

The policy also contained a breach of warranty endorsement, which named GECC, as the lienholder, a beneficiary. The breach of warranty clause, like a mortgage clause, provided that the lienholder's insurance will not be invalidated by any negligent or intentional actions taken by the named insured. *Don Chapman Motor Sales, Inc. v. National Savings Insurance, Co.*, 626 S.W.2d 592, 597 (Tex.App. — Austin 1981, writ ref'd n.r.e.). Under Texas law, the breach of warranty endorsement constituted a separate and independent contract between National Union, as the insurer, and GECC, as the lienholder. *St. Paul Fire & Marine Insurance Co. v. Crutchfield*, 350 S.W.2d 534, 537 (Tex.1961); *Don Chapman*, 626 S.W.2d at 597. The parties to this suit do not dispute that the

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2. The breach of warranty endorsement contained this same phrase. (III R. 35).

coverage created in the basic policy was part of the contract created by the breach of warranty endorsement.[3]

The breach of warranty endorsement excluded from coverage losses resulting from "conversion, embezzlement or secretion by or at the direction of the Named Insured." (III R. 35). Appellants argue that the "confiscation" language in the war risk endorsement explicitly covered the losses in this case, and that the "notwithstanding anything in the policy to the contrary" language overrides the "conversion" exception in the breach of warranty endorsement. This ignores the last sentence of the war risk endorsement, which states that nothing in the endorsement shall "vary, alter, waive or extend" the terms of the policy except as stated in the endorsement. (III R. 31). Both the basic policy and the breach of warranty endorsement excluded losses following a conversion. The extension of coverage for "confiscation" under the war risk endorsement is not "contrary" to the policy exclusion for conversion. Confiscation and conversion are not identical and coverage for one can coexist in a policy containing an exclusion for the other.

The result appellants seek would make the conversion exclusion to the breach of warranty endorsement meaningless. The conversion here occurred when Care Flight subleased the aircraft. Coverage under the breach of warranty endorsement terminated at that time. The later confiscation by the Colombian government did not resurrect coverage. Once Care Flight converted the aircraft, potential insurance coverage for a subsequent event became irrelevant. *See, e.g., Fidelity & Cas. Co. of New York v. Central*

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3. The parties do dispute whether the territorial exclusions contained in the basic policy limit the coverage contained in the breach of warranty endorsement. However, our disposition of this case makes it unnecessary to reach this question.

*Bank of Houston*, 672 S.W.2d 641 (Tex. App. — Houston [14th Dist.] 1984, writ ref'd n.r.e.).

For the above reasons, we find that, as a matter of law, the insurance contract excluded GECC's recovery for losses incurred due to Care Flight's conversion of the aircraft.

V. Attorney's Fees

Texas law provides for the award of attorney's fees under Tex.Civ.Prac. & Rem. Code § 37.009 (West 1986), which provides that "[i]n any proceeding under this chapter, the court may award costs and reasonable and necessary attorney's fees as are equitable and just." The award of attorney's fees in a declaratory judgment action "lies within the discretion of the trial court, and its judgment will not be reversed on appeal absent a clear showing that it abused that discretion." *Oake v. Collin County*, 692 S.W.2d 454, 455 (Tex.1985) (citations omitted).

National Union contends that the district court erred by refusing to award attorney's fees that National Union incurred in defending a separate lawsuit in the Eastern District of Texas concerning the same issues. The district court judge ruled that National Union was only entitled to attorney's fees incurred in the case in that judge's court. Section 37.009 allows the discretionary award of fees incurred "in any proceedings under this chapter." National Union has not cited, and this court has not found, a case awarding a litigant fees incurred in a separate but related case. There is no basis to find that the district court abused its discretion in denying National Union's claim for attorney's fees incurred in the Eastern District of Texas litigation.

The summary judgment is AFFIRMED.

## APPENDIX B — FINAL JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION FILED FEBRUARY 16, 1993

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-91-1187-H

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,

Plaintiff,

v.

CARE FLIGHT AIR AMBULANCE SERVICE, INC., GENERAL ELECTRIC CAPITAL CORPORATION, and AVEMCO INSURANCE COMPANY,

Defendant.

JUDGMENT

On November 2, 1992, the Court signed its Memorandum Opinion and Order granting Plaintiff's Motion for Summary Judgment. Defendants General Electric Capital Corporation and AVEMCO Insurance Company filed their Motion Under Fed. R. Civ. P. 59 for New Trial and to Alter Judgment and Brief in Support on November 18, 1992. Plaintiff's Response to Defendants' Motion for New Trial was filed on December 15, 1992. Based on those court papers, the Court denies Plaintiffs' Motion for New Trial consistent with its Memorandum Opinion and Order dated January 19, 1993. Plaintiff's Motion for Summary Judgment is

granted consistent with the Court's Memorandum Opinion and Order dated November 2, 1992.

IT IS, THEREFORE, ORDERED that Plaintiff have declaratory judgment that there is no contractual obligation of Plaintiff and that Plaintiff has no liability to pay proceeds, in cash or otherwise, for any alleged loss incurred by Defendants General Electric Capital Corporation and AVEMCO Insurance Company for any alleged damages to the aircraft described as one Piper Cheyenne 400LS, FAA Registration No. N41198 under any insuring agreement between Plaintiff National Union Fire Insurance Company of Pittsburgh, Pennsylvania and Defendants Care Flight Air Ambulance Service, Inc., General Electric Capital Corporation, and AVEMCO Insurance Company.

IT IS FURTHER ORDERED that Defendants' Motion Under Fed. R. Civ. P. 59 for New Trial and to Alter Judgment is denied.

IT IS FURTHER ORDERED that Plaintiff National Union Fire Insurance Company of Pittsburgh, Pennsylvania have judgment against the Defendants Care Flight Air Ambulance Service, Inc., General Electric Capital Corporation, and AVEMCO Insurance Company, jointly and severally, for attorney's fees totaling $59,509.50 and expenses totaling $6,904.79.

All other relief not expressly granted herein is denied.

s/ Barefoot Sanders
JUDGE BAREFOOT SANDERS, CHIEF
JUDGE, UNITED STATES DISTRICT
COURT FOR THE NORTHERN
DISTRICT OF TEXAS

Feb. 12, 1993

## APPENDIX C — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION FILED JANUARY 19, 1993

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-91-1187-H

NATIONAL UNION FIRE INSURANCE COMPANY of PITTSBURGH PA.,

Plaintiff,

v.

CARE FLIGHT AIR AMBULANCE SERVICE, INC., GENERAL ELECTRIC CAPITAL CORPORATION, and AVEMCO INSURANCE COMPANY,

Defendants.

MEMORANDUM OPINION AND ORDER

Before the Court are Defendants General Electric Capital Corporation ("GECC") and Avemco Insurance Company's ("Avemco") Motion for Reconsideration, filed November 19, 1992; Plaintiff National Union Fire Insurance Company's ("National Union") Response, filed December 15, 1992; and Defendants' Reply, filed December 29, 1992.

*Appendix C*

I. Background

This suit revolves around a dispute over the extent of National Union's insurance coverage on a Cheyenne 400LS twin engine turbo-prop airplane owned by GECC and leased to Care Flight Air Ambulance Services, Inc. ("Care Flight"). On November 2, 1992, the Court granted National Union's motion for summary judgment, concluding that when Care Flight, the named insured under National Union's insurance policy, subleased the aircraft in question to James Coltharp, Care Flight converted the aircraft, eliminating National Union's duty to honor the Breach of Warranty Endorsement which benefited GECC. A more complete recitation of the facts involved in this case can be found in the Court's November 2, 1992 Memorandum Opinion and Order.

II. The Present Motion

Defendants now move the Court to reconsider its earlier decision. Defendants forward several arguments in support of their motion. First, Defendants claim that the conversion exclusion contained within the Breach of Warranty Endorsement is superseded by the extended coverage of the insurance policy's War Risk Endorsement. Second, Defendants contend that under the terms of the GECC/Care Flight lease, the contractual duty against subleases supersedes the tort duty against conversion, and, as a matter of law, no conversion arises. Third, Defendants argue that a demand and refusal are required in this case before the Court can conclude that conversion has occurred. Finally, Defendants challenge the sufficiency of National Union's attorney's fees affidavit.

Defendants first argue that the coverage provided by the policy's War Risk Endorsement supersedes the conversion

exclusion contained within the Breach of Warranty Endorsement. National Union correctly notes that Defendants failed to raise this contention in their briefs on the motion for summary judgment; nevertheless, the Court will briefly consider this point.

In their briefs on the motion for summary judgment, Defendants argued, and the Court agreed, that GECC was not subject to the terms and conditions of the National Union/Care Flight policy but, instead, derived its rights from a separate contract with National Union, the Breach of Warranty Endorsement. The Court concluded that National Union could not escape its duty to compensate GECC simply because of the territorial restrictions included in the policy because the Court concluded that this restriction only applied to Care Flight. Now, Defendants claim that the War Risk Endorsement of the National Union/Care Flight policy provides them with coverage. However, since the Court has previously concluded that Defendants derived their rights from a separate contract, the Breach of Warranty Endorsement, and that they were not subject to the exclusions of the principal policy, Defendants cannot claim the benefit of an inclusion which appeared in the National Union/Care Flight policy but not in the Breach of Warranty Endorsement.

Nevertheless, in a reversal of their earlier position, Defendants claim that they *are* beneficiaries under the National Union/Care Flight policy. Specifically, Defendants claim that they are "additional insureds" and "loss payees" under the principal policy. However, GECC is defined to be an "Additional Insured on Aircraft Liability Coverage" alone. GECC is not an additional insured under the portion of the National Union/Care Flight policy at issue here, the "Physical Damages coverage." Furthermore, although GECC is defined to be a "loss payee for Aircraft Physical Damage Coverage", for reasons that are discussed below, this

clause does not allow Defendants to receive benefits under the principal policy.

As a "loss payee", GECC has the same rights as the named insured, Care Flight, under the National Union Policy. However, GECC is also subject to the same defenses that National Union may have against Care Flight. This Court has already concluded that the sublease from Care Flight to Coltharp constituted conversion and, thereby, voided GECC's right to recover under the Breach of Warranty Endorsement. The National Union/Care Flight policy also contains an exclusion which indicated that the policy does not apply to "loss or damage due to conversion, embezzlement or secretion by any person in possession of the aircraft under a bailment, lease, conditional sale, purchase agreement, mortgage or other encumbrance, nor for any loss or damage resulting therefrom." *See* Policy at 2. Given the Court's conclusion that the unauthorized sublease of the aircraft to Coltharp constituted conversion and the term in the principal policy which eliminated coverage for any "loss or damage due to conversion", the Court concludes Care Flight, and hence GECC, has no right to recover under the National Union policy.

Defendants argue that, although coverage was eliminated after the sublease to Coltharp, the War Risk Endorsement resurrects coverage for the aircraft if a loss occurs by "confiscation . . . seizure, restraint, [or] detention . . . by or under the order of any Government." However, the Court has concluded that National Union's duty to cover the plane ended at the time Care Flight subleased the aircraft to Coltharp. At this point, National Union was no longer liable to Care Flight or Defendants. This conclusion ends the inquiry. The occurrence of subsequent events which may have been covered under the policy has no bearing on the fact that coverage was eliminated by Care Flight's conversion of the

aircraft. *See Fidelity & Cas. Co. v. Central Bank of New York*, 672 S.W.2d 641 (Tex. App. — Houston [14th Dist.] 1984, writ ref'd n.r.e.).

Defendants last two substantive points raise additional arguments against the Court's conclusion that Care Flight's sublease of the aircraft to Coltharp constituted conversion. After considering these arguments, the Court has not been persuaded that its original holding is erroneous. Therefore, the Court concludes that Defendants' motion for reconsideration is DENIED.

Finally, Defendants challenge the sufficiency of National Union's attorney's fees affidavit. Defendants argue that the affidavit attesting to the reasonableness of the attorney's fees incurred in this action is conclusory and fails to delineate the specific hours spent by the various representatives of National Union and the hourly rate which they charge. Moreover, Defendants question whether the affidavit refers to attorney's fees incurred in this action alone or the fees incurred in this action along with a similar action pending in the United States District Court for the Eastern District of Texas. Defendants also question the reasonableness and necessity of the $81,824.82 of attorney's fees claimed in this action.

The Court finds these objections sound. The Court notes, though, that National Union's counsel has requested leave to file a more particularized affidavit, articulating the basis for its attorney's fees request. Counsel for National Union is directed to file such an affidavit no later than *noon, January 29, 1993.*

*Appendix C*

III. Conclusion

Defendants' motion for reconsideration is *DENIED*. Counsel for National Union is directed to file its attorney's fees affidavit, along with a proposed judgment, no later than *noon, January 29, 1993*.

SO ORDERED.

DATED: January 19, 1993.

s/ Barefoot Sanders
BAREFOOT SANDERS, CHIEF JUDGE
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS

## APPENDIX D — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION FILED NOVEMBER 2, 1992

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3-91-1187-H

NATIONAL UNION FIRE INSURANCE COMPANY of PITTSBURGH PA.,

Plaintiff,

v.

CARE FLIGHT AIR AMBULANCE SERVICE, INC., GENERAL ELECTRIC CAPITAL CORPORATION, and AVEMCO INSURANCE COMPANY,

Defendants.

MEMORANDUM AND ORDER

Before the Court are Plaintiff National Union Fire Insurance Company's ("National Union") Motion for Summary Judgment, filed July 14, 1992; General Electric Capital Corporation ("GECC") and Avemco Insurance Company's ("Avemco") Response, filed July 31, 1992; National Union's Reply filed August 17, 1992; and Defendants' Response to Reply, filed October 2, 1992.

*Appendix D*

## I. Background

This is a dispute over the extent of National Union's insurance coverage on a Cheyenne 400LS twin engine turbo-prop airplane owned by GECC and leased to Care Flight Air Ambulance Services, Inc. ("Care Flight"). Initially, the parties believed that the aircraft in question would be a total loss because the government of Colombia had confiscated it. However, Colombian authorities released the plane, thereby reducing the damage to the plane to the cost of repair, costs which National Union may be obligated to pay. Avemco, which insures GECC's entire fleet of aircrafts, paid GECC approximately $2,300,000 under the fleet policy before the Colombians released the plane. Now, Avemco seeks to recover this amount from National Union, the company which issued a policy insuring Care Flight, claiming that Avemco is subrogated to GECC's right to be paid by National Union. In this case, National Union seeks a declaration pursuant to the federal Declaratory Judgment Act, 28 U.S.C. §§2201-02, that no coverage exists because Care Flight violated the terms and conditions of its insurance policy with National Union.

## II. Summary Judgment

Summary judgment is proper when the pleadings and evidence on file show that no genuine issue exists as to any material fact and that the moving party is entitled to judgment or partial judgment as a matter of law. *See* Fed. R. Civ. P. 56. As the Fifth Circuit stated in *Christophersen v. Allied-Signal Corp.*, 902 F.2d 362, 364 (5th Cir. 1990), "[b]efore a court may grant summary judgment, the moving party must demonstrate that it is entitled to judgment as a matter of law because there is no actual dispute as to an essential element of the plaintiff's case." A movant for summary judgment need not support the motion with evidence negating the

opponent's case; rather, the movant must show only that the opponent's case lacks the evidence it needs to defeat summary judgment. *See Celotex Corp. v. Catrett,* 477 U.S. 317, 323-25 (1986).

Once the moving party shows that it is entitled to summary judgment, the burden shifts to the nonmoving party to "come forward with 'specific facts showing that there is a *genuine issue for trial.*' " *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986) (emphasis in original) (*quoting* Rule 56(e)); *see also Fontenot v. Upjohn Co.*, 780 F.2d 1190, 1195-98 (5th Cir. 1986). However, all evidence must be viewed in the light most favorable to the motion's opponent. *See Gremillion v. Gulf Coast Catering Co.*, 904 F.2d 290, 292 (5th Cir. 1990).

Summary judgment may be entered against a party if, after adequate time for discovery, the party fails to establish the existence of an element essential to his or her case and as to which he or she will bear the burden of proof at trial. *See Celotex,* 477 U.S. at 324-26.

## III. Analysis

National Union seeks a declaration from this Court that it is not obligated to pay for the damage to the aircraft in question. In its Motion for Summary Judgment, National Union makes three arguments in support of its position. First, National Union asserts that Care Flight violated the terms of its insurance policy and voided coverage by allowing the plane to be flown outside of the insured territory. Second, National Union states that Care Flight converted the plane by wrongly subleasing it to a person who allowed the damage to the plane to occur, hence violating the policy and voiding coverage. Third, National Union argues that it is not obligated to cover the damage the plane suffered because

Care Flight violated the policy by allowing the plane to be used for illegal purposes, specifically, the transportation of narcotics. After canvassing National Union's summary judgment evidence, the Court will address each of these contentions in turn.

The relevant factual contentions that National Union has made are as follows:

1. David Ballard, the founder of Care Flight approached GECC and inquired about leasing the airplane in question. James Coltharp, Ballard's father-in-law, provided the money used to lease the plane, *see* Coltharp Deposition at 25, 44-46, although he was not an employee, officer, director, or agent of Care Flight. *See id.* at 74-5. Care Flight then leased the plane from GECC. *See* Motion for Summary Judgment Exhibit C.

2. Coltharp subleased the plane from Care Flight, *see* Motion for Summary Judgment Exhibit D. Coltharp then subleased the aircraft to Anthony Contraras, *see* Coltharp Deposition at 41-2, 77.

3. Coltharp delivered the plane to Contraras for his alleged use in a gold mining business in Brazil. *See* Coltharp Deposition at 21-23.

4. In addition to flying the plane to Brazil, Coltharp stated that he and Contraras flew the plane to Panama, Puerto Rico, and Colombia. *See id.* at 23-24, 69-70, 72-74.

The parties seem to agree that the plane suffered some damage during the time the plane was subleased to Coltharp, and that, at some point, the plane was confiscated by the Colombian government. However, National Union failed to submit any specific undisputed facts to support these points.

*Appendix D*

A. Territorial Limitations on the Policy

First, National Union claims that the territorial restrictions on its insurance policy preclude any recovery by GECC, which claims to be covered under the Breach of Warranty Endorsement to that policy.[1] National Union contends that the policy applies only if a loss occurs in the United States, Canada, or Mexico. National Union also asserts that this territorial restriction is a condition precedent to recovery, applying to both the named insured, Care Flight, and to the owner of the plane, GECC. Since Care Flight allowed the plane to be flown to Colombia and other destinations outside of the insured territory, National Union believes that it is not required to pay GECC for any damage to the plane.

Specifically, National Union notes that the insurance policy between it and Care Flight "applies only to . . . physical damages losses to the aircraft which are sustained during the policy period, while the aircraft is within the United States of America, Canada, and Mexico or enroute between ports thereof." *See* Motion for Summary Judgment Exhibit A at 1, ¶ VI. National Union notes that if damage occurs outside of these countries, insurance coverage will not exist for Care Flight. National Union then argues that this exclusion also precludes any recovery by GECC under the Breach of Warranty Endorsement of the National Union policy.

GECC and Avemco ("Defendants") respond that the Breach of Warranty Endorsement contained in National Union's policy is a separate contract which is not subject to the territorial limitations found in the principal policy. Defendants thus contend that the

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1. This section of the Court's Opinion will not address the validity of the National Union policy as to Care Flight, the named insured, because that issue was not clearly presented to the Court.

territorial restrictions contained in the insurance contract only affect the coverage of the named insured, Care Flight, and do not apply to the separate contract with GECC.

Defining GECC as a "lienholder", the Breach of Warranty Endorsement to the National Union policy states that:

> As to the interest of such lienholder only [i.e. GECC], the Insurance afforded by any Physical Damage Coverage of this policy shall not be invalidated by any act or neglect of the Named Insured nor by any change in the title or ownership of the aircraft but conversion, embezzlement or secretion by or at the direction of the Named Insured is not covered hereunder . . . .

Under Texas law, and the majority of jurisdictions elsewhere, warranty endorsements and clauses such as this one are considered to be independent agreements between the insurers and the defined lienholders. These endorsements are separate from the contracts between insurers and the insureds. *See Lexington Ins. Co. v. Gray,* 775 S.W.2d 679, 683 (Tex. App. — Austin 1989, writ denied). Such endorsements, like standard mortgage clauses in fire and automobile insurance policies, provide that insurance coverage for the lienholder or mortgagee will not be invalidated by any act or neglect of the named insured. Thus, under these clauses, grounds on which an insurer may refuse to compensate a named insured do not apply to a lienholder. *See Don Chapman Motor Sales, Inc. v. National Savings Ins. Co.,* 626 S.W.2d 592, 595 (Tex. Civ. App. — Austin 1981, writ ref'd n.r.e.) ("This contract between the insurer and the mortgagee can be invalidated solely by acts of the mortgagee, and is not affected by any act or neglect of the

mortgagor in violation of the policy of which the mortgagee is uninformed.") (quoting 5A J. Appleman. *Insurance Law and Practice* §3401 (1970)); *see also Travelers Indemnity Co. v. Storecraft, Inc.*, 491 S.W.2d 745, 748 (Tex. Civ. App. — Corpus Christi 1973, no writ).

The Texas courts' construction of breach of warranty endorsements conforms with the view of most decisions nationwide. For example, the Minnesota Supreme Court decided a case involving a standard mortgage clause in a fact pattern rather similar to the one presently before the Court. In *American National Bank & Trust Co. v. Young*, 329 N.W.2d 805 (Minn. 1983), the court held that a standard mortgage clause, like the one involving National Union and GECC, constituted "an independent contract of insurance which cannot be invalidated by acts or neglect of the mortgagor." *Id.* at 811.

The Minnesota court also explicitly rejected the insurer's argument that the breach of warranty endorsement was subject to the conditions and exclusions contained in the principal policy between the insurer and the named insured, an argument that National Union, the insurer, attempts to make here. The court construed a section of the standard mortgage clause which provided that "nothing contained herein shall vary the terms of the underlying policy" (a clause which is strikingly similar to a clause in the Breach of Warranty Endorsement in the National Union policy) to mean that:

> the issuance of a separate insurance policy to the mortgagee protecting it from the wrongful acts or neglect of mortgagor, shall not vary the respective legal positions of the insured and insurer under the terms of the policy.

*Young*, 329 N.W.2d at 811. Applying this reasoning to the present case, the language in the National Union policy which states that the Breach of Warranty Endorsement will not alter the terms of the policy indicates that the Endorsement will not affect the respective positions of National Union and Care Flight.

The court sees no reason to analyze the Breach of Warranty Endorsement in the National Union-Care Flight insurance policy any differently than other courts which have considered these endorsements previously. Sine the Breach of Warranty Endorsement is a separate contract between the insurer and the lienholder, the territorial limits of the main policy do not apply to the lienholder, GECC. National Union's first argument thus provides it no basis on which to prevail on its motion for summary judgment.

B. Conversion

The second ground on which National Union bases its motion for summary judgment is that the sublease from Care Flight to Coltharp constitutes conversion by or at the direction of the named insured. National Union observes that Exclusion 6(a) to the Care Flight-National Union agreement provides that the "policy does not apply: to loss or damage due to conversion, embezzlement or secretion by any person in possession of the aircraft under a bailment, lease, conditional sale, purchase agreement, mortgage or other encumbrance, nor for any loss or damage resulting therefrom." *See* Motion for Summary Judgment Exhibit A at 2. National Union also notes that the Breach of Warranty Endorsement, the contract which governs GECC's rights, states that any "conversion, embezzlement or secretion by or at the direction of named insured [Care Flight] is not covered hereunder." National Union claims that a conversion has occurred

because Care Flight leased the aircraft to Coltharp, and that the coverage to GECC has thereby been voided.[2] However, Defendants contend that, as a matter of law, no conversion has occurred. Defendants argue that when Care Flight subleased the aircraft, it did not convert the plane.

Initially, the Court notes that the Breach of Warranty Endorsement states that GECC will not be entitled to recover if there is any "conversion . . . *by or at the direction of* the Named Insured [Care Flight]." (emphasis added). Thus, the issue is whether there was any conversion by Care Flight or at its direction. Under the policy, any conversion by or at the direction of anyone else is immaterial.

The definition of conversion is well established in Texas. Conversion is "[t]he wrongful exercise of dominion and control over another's property in denial of or inconsistent with [the owner's] rights." *Tripp Village Joint Venture v. MBank Lincoln Centre. N.A.*, 774 S.W.2d 746, 750 (Tex.App.—Dallas 1989, writ denied); *see also Richter S.A. v. Bank of America Nat'l Trust & Sav. Ass'n*, 939 F.2d 1176, 1191 (5th Cir. 1991); *In re Moody*, 899 F.2d 383, 385 (5th Cir. 1990). Applying this abstract definition to concrete cases has proven to be more difficult.

The principal question becomes whether the sublease from Care Flight to Coltharp constituted conversion. A preliminary question to address, however, is whether a violation of a contractual obligation can constitute conversion at all. National Union contends that the use or misuse of a chattel beyond that which the owner has agreed to, such as an unauthorized sublease, constitutes conversion. Defendants, though, note that the lease

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2. Again, the Court's opinion will only address GECC's right to recover because National Union did not clearly present its case against Care Flight.

between GECC and Care Flight required only the prior permission of GECC before Care Flight could sublease the aircraft. They argue that the lease did not in all respects *prohibit* subleasing the plane. Moreover, Defendants claim that while the sublease to Coltharp may have been a breach of the contract between GECC and Care Flight, it cannot be characterized as a tort of conversion. In support of their position, Defendants analogize this case to *Southwestern Bell Telephone Co. v. DeLanney,* 809 S.W. 493 (Tex. 1991), to show that a tort cannot arise out of a breach of a contractual obligation. In *DeLanney,* the Texas Supreme Court held that the plaintiff could not assert both a tort claim and a contract claim based upon Southwestern Bell's failure to publish an advertisement in the Yellow Pages. *See id.* at 494.

However, Defendants are mistaken in their general argument that no tort can arise between parties when their relationship is governed by a pre-existing contract. No such categorical statement can be made. For example, Texas courts have sanctioned tort recoveries when an insurer breaches its duty of good faith and fair dealing with its insured. *See Arnold v. National County Mut. Fire Ins. Co.,* 725 S.W.2d 165, 167 (Tex. 1987). Professional malpractice suits provide another counter-example to Defendant's argument.

More particularly, Defendants point to no law which states that a breach of a contractual arrangement in itself cannot constitute a conversion. Indeed, the common law clearly indicates that misuse or use beyond which the owner consented may give rise to a conversion. *See* American Jurisprudence, *Conversion* §52 at 182 (1985). There is no reason why the phrase "beyond which the owner consented" cannot mean beyond the terms of a contract entered into between the owner and person in possession.

Similarly, the Restatement (Second) of Torts notes that "one who is authorized to make a particular use of a chattel, and uses it in a manner exceeding the authorization, is subject to liability for conversion to another whose right to control the use of the chattel is thereby seriously violated." Restatement (Second) of Torts 228 (1965). Specifically, comment c to this section of the Restatement notes that "The limits of the permitted use ordinarily are determined by the terms, express or reasonably to be implied, of the *contract or the agreement* between the parties, and the question becomes one of whether there is a material breach of the agreement." (emphasis supplied). Thus, there can be little question that a breach of a contract can give rise to a conversion. *See generally Swish Mfg. Southeast v. Manhattan Fire & Marine Ins. Co.*, 675 F.2d 1218, 1221 (11th Cir. 1982) (applying Restatement §228); *Gelder v. Puritan Ins. Co.*, 668 P.2d 1117, 1118 (N.M.Ct. App. 1983) (same). Next, the Court must consider whether Care Flight's unauthorized use of the aircraft is serious enough to constitute conversion. Comment d to 228 of the Restatement (Second) of Torts provides that

> Even where there is a clear breach of the agreement, however, the unpermitted use is not a conversion unless it amounts to such a *serious* violation of the other's right of control as to justify requiring the user to pay the full value of the chattel. Most unpermitted uses are sufficiently serious to constitute such a material violation. There may, however, be minor, temporary, and unimportant deviations from the authorized use, which do not harm and are not intended as a defiance of the other's rights, and so are not of enough significance to be treated as conversion. This is true in particular where the use made is of the same

> kind as that permitted, but exceeds it for a brief length of time, or in a relatively slight degree, so that the breach of the agreement is a relatively technical one, which would not support the recovery of substantial damages in an action for breach of contract. (emphasis supplied).

The question in this case is whether Care Flight's breach of its lease with GECC is a serious violation of GECC's rights. Illustration 6 to §228 of the Restatement seems applicable to the case at hand. In that example, A rents an automobile to B to drive to X City and return. In violation of the agreement, B drives to Y City. While in Y City, the car is seriously damaged in a collision, with or without negligence on the part of B. The Restatement concludes that this is a conversion.

In this case, Care Flight subleased the aircraft to Coltharp. This act breached Care Flight's lease to GECC. While Coltharp had subleased the plane, through no fault on the part of Care Flight, the plane was damaged and detained in Colombia. According to the reasoning of illustration 6, the sublease to Coltharp is a conversion on the part of Care Flight, even though Care Flight technically may not have been responsible for the damage to the plane or the plane's detention in Colombia.

Moreover, section 6(g) of the GECC-Care Flight lease explicitly prohibits subleasing the aircraft without the prior approval of GECC. *See* Motion for Summary Judgment Exhibit C at 4. There is no indication that Care Flight obtained the required permission. Furthermore, paragraph 12 of the GECC-Care Flight lease notes that any violation of paragraph 6 is considered to be an event of default. *See id.* at 8.

*Appendix D*

The Court determines that the unauthorized sublease was a use of the plane which constituted a material breach of the Care Flight-GECC lease. The Court thus concludes that the sublease without GECC's permission, which resulted in damage to and detention of the plane, is serious enough to constitute conversion.

Finally, the Court notes that Defendants argue that, under Texas law, when possession of the property in question is lawful at the outset, conversion can only occur when the possessor refuses the owner's demand for return of the property. Defendants reason that since possession of the plane was lawful, and because they made no demand for the return of the aircraft, there can be no finding of conversion.

However, Defendants' argument that conversion requires a demand for possession and a refusal is an incomplete statement of Texas law. In *Loomis v. Sharp,* 519 S.W.2d 955 (Tex.Civ.App. — Texarkana 1975, writ dism'd), a Texas court noted that a formal demand and refusal are not necessary when "the circumstances and the acts of the possessor authorize a finding . . . of a clear repudiation of the owner's rights and are tantamount to a refusal after demand." *Id.* at 958; *see also Permian Petroleum Co. v. Petroleos Mexicanos,* 934 F.2d 635, 651 (5th Cir. 1991) (citing *Loomis*). Thus, the demand requirement seems to act as a surrogate for proof of conversion, applicable when conversion cannot otherwise be shown. This reading of Texas law is supported by earlier cases. For example, in *Presley v. Cooper,* 284 S.W.2d 138 (Tex. 1955), the court noted that a demand and refusal are not necessary if other evidence establishes an act of conversion. The court noted that where a conversion "cannot otherwise be shown than by [the] refusal to comply with the demand for possession, such a demand and refusal are necessary. But they are not necessary if the other evidence establishes an act of conversion."

*Id.* at 141. The Court has previously concluded that the unauthorized sublease clearly violated the GECC-Care Flight contract and led to damage to the plane. Hence, other evidence has established an act of conversion. Therefore, there was no need for GECC to demand the return of the aircraft.

Since the Court has found that Care Flight converted the aircraft when it subleased the plane to Coltharp, the exclusion contained in the Breach of Warranty Endorsement for conversion by or at the direction of Care Flight voids any coverage for GECC under the National Union policy.

C. Illegal Activity

The third ground on which National Union bases its motion for summary judgment is its claim that Care Flight allowed the plane to be used for illegal purposes. However, given the Court's conclusion on the conversion issue, and noting the fact that National Union has failed to establish that there are no genuine issues of fact on this subject, the Court declines to address this contention.

IV. Conclusion

National Union's Motion for Summary Judgment is *GRANTED.* National Union is *directed* to submit a proposed judgment no later than *noon. November 9, 1992.*

SO ORDERED.

DATED: November 2, 1992.

*Appendix D*

s/ Barefoot Sanders
BAREFOOT SANDERS, CHIEF JUDGE
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS

## APPENDIX E — BREACH OF WARRANTY ENDORSEMENT

### BREACH OF WARRANTY ENDORSEMENT

In consideration of an additional premium of $ *Included,* it is agreed that loss, if any, under any Physical Damage coverage provided by this policy, shall be payable to the insured, and *General Electric Capital Corp., 206 Danbury Road, Wilton CT. 06897* (hereinafter called the Lienholder) as interest may appear

1. As to the interest of the said Lienholder only, the Insurance afforded by any Physical Damage Coverage of this policy shall not be invalidated by any act or neglect of the Named Insured nor by any change in the title or ownership of the aircraft but conversion, embezzlement or secretion by or at the direction of the Named Insured is not covered hereunder; provided however that:

(a) in case the Named Insured shall neglect to pay any premium due under this policy the Lienholder shall, on demand, pay the premium; and

(b) the Lienholder shall notify the Company of any change of title or ownership of the aircraft or apparent increase of hazard, which shall come to the knowledge of the Lienholder, and, unless permitted by this policy, it shall be endorsed thereon and the Lienholder shall, on demand, pay the premium for such increased hazard.

2. The liability of the Company to any Lienholder under the provisions of Paragraph 1 of this endorsement shall not exceed:

(a) the unpaid balance due on liens pertaining to the aircraft less unearned interest and unpaid installments more than 10 days overdue on the date of loss or damage if any balance remains after the Lienholder has used all reasonable means to collect amounts due from the Named Insured; nor

*Appendix E*

(b) the amount of lien recited in paragraph 6 of this endorsement, which would have remained unpaid at the time of the loss or damage had all payments been made when not more than 10 days overdue; nor

(c) the Insured Value of the aircraft as stated in this policy, whichever is less.

3. Whenever the Company shall pay any sum for loss, damage or expense under any Physical Damage Coverage of this policy and claim that, as to the Named Insured, no liability existed therefor, the Lienholder shall thereupon, to the extent of such payment, assign, deliver and convey all interest that the Lienholder may have in said aircraft, all instruments of security pertaining thereto and rights against the Named Insured, to the Company. The Named Insured agrees to promptly reimburse the Company for any sum paid for loss, damage or expense which the Company would not have been obligated to pay but for the provisions of paragraph 1 of this endorsement.

4. No provision in this policy in relation to deductions from any loss payable, shall be applicable to any payment to the Lienholder under Paragraph 1 of this endorsement other than as set forth in this endorsement.

5. In the event this policy or this endorsement is cancelled by the Company 30 days (ten days if for nonpayment of premium) prior notice shall be sent to the said Lienholder named herein.

6. This endorsement shall be applicable only with respect to the aircraft identified below.

*Appendix E*

| Aircraft F.A.A. Cert. No. | Amount of Lien |
|---|---|
| N41198 | $2,330,000.00 |

Nothing herein contained shall vary, alter, waive or extend any of the terms, provisions, representations, conditions or agreements of the policy other than as above stated.

This endorsement becomes effective *March 5, 1989* to be attached to and hereby made a part of Policy No. *AV538-6566* issued to *Care Flight Air Ambulance Services, Inc.*

This endorsement shall not be valid unless approved by the Aviation Managers of the company.

Endorsement No. *5*

Date of Issue *04/10/89*

- ☐ Southeastern Aviation Underwriters, Inc.
- ☒ Southeastern Aviation (California) Insurance Services, Division of Southeastern Aviation Underwriters, Inc.
- ☐ Southeastern Aviation (Texas), Inc.
- ☐ Southeastern Aviation (Illinois) Corp.

AT/kj

By _____
AVIATION MANAGERS

## APPENDIX F — THE WAR RISK ENDORSEMENT

### EXTENDED COVERAGE ENDORSEMENT

In consideration of $ *Include* additional premium, it is understood and agreed that notwithstanding anything in the policy to the contrary, this endorsement provides the coverages shown below.

### SECTION ONE – LOSS OF OR DAMAGE TO AIRCRAFT

Subject to the terms, conditions and limitations set out below, this endorsement covers physical loss of or damage to the aircraft specified in item 4 of the Declarations page caused by:

(a) War, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, martial law, military or usurped power or attempts at usurpation of power.

(b) Strikes, riots, civil commotions or labor disturbances.

(c) Any act of one or more persons whether or not agents of a sovereign power for political or territorist purposes and whether the loss or damage resulting therefrom is accidental or intentional.

(d) Any malicious act or act of sabotage.

(e) Confiscation, nationalization, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any Government (whether civil military or de facto) or public or local authority.

(f) Hi-jacking or any unlawful seizure or wrongful exercise of control of the aircraft or crew in flight (including any attempt

at such seizure or control) made by any person or persons on board the aircraft acting without the consent of the insured.

Furthermore, this endorsement covers claims while the aircraft is outside the control of the Insured by reason of any of the above perils (a) through (f). The aircraft shall be deemed to have been restored to the control of the Insured on the safe return of the aircraft to the Insured at an airfield not excluded by the geographical limits of this endorsement and entirely suitable for the operation of the aircraft (such safe return shall require that the aircraft be parked with engines shut down and under no duress).

## SECTION TWO – EXTORTION COVERAGE

The Company agrees to indemnify the insured subject to the provisions below for any payment properly made in respect of threats against the aircraft, its passengers, or crew, made during the currency of this endorsement.

## SECTION THREE – HI-JACKING EXPENSE COVERAGE

The Company agrees to indemnify the insured subject to the provisions below, for any payment properly made in respect of extra expenses necessarily incurred following confiscation, etc. (as per Section One Clause) (e)) or hi-jacking, etc. (as per Section One Clause (f) or the aircraft.

## SECTION FOUR – GENERAL EXCLUSIONS

This endorsement excludes loss, damage or expense caused by any of the following:

(a) War (whether there be a declaration of war or not) between

any of the following States: United Kingdom, United States of America, France, the Union of Soviet Socialist Republics, the People's Republic of China; nevertheless, if the aircraft is in the air when an outbreak of such war occurs, this exclusion shall not apply in respect of such aircraft until the said aircraft has completed its first landing thereafter.

(b) Any detonation of any weapon of war employing atomic or nuclear fission and/or fusion, or other like reaction or radioactive force or matter whether hostile or otherwise.

(c) Any debt failure to provide bond or security or any other financial cause under court order or otherwise.

(d) the repossession or attempted repossession of the aircraft either by any title holder or arising out of any contractual agreement to which any insured protected under this endorsement may be party.

(e) Delay, loss of use, or except as specifically provided in Section Two, any other consequential loss whether following upon loss of or damage to the aircraft or otherwise.

–TURN PAGE OVER FOR REMAINDER OF ENDORSEMENT–

Nothing herein contained shall vary, alter, waive or extend any of the terms, provisions, representations, conditions or agreements of the policy other than as above stated.

This endorsement becomes effective *March 5, 1989* to be attached to and hereby made a part of Policy No. *AV538-6566* issued to *Care Flight Air Ambulance Services, Inc.*

*Appendix F*

This endorsement shall be valid unless approved by the Aviation Managers of the Company.

Endorsement No. *8*

Date of Issue *04/10/89*

- ☐ AIG Aviation, Inc.
- ☒ AIG Aviation Insurance Services
- ☐ AIG Aviation (Canada), Inc.
- ☐ AIG Aviation (Illinois) Corporation
- ☐ AIG Aviation (Texas), Inc.

AT/kj

By_____
AVIATION MANAGERS